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Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of human rights, particularly economic, social and cultural rights

Note by the Secretariat

The Secretariat has the honour to transmit to the Human Rights Council the thematic report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Juan Pablo Bohoslavsky, prepared pursuant to Council resolution 25/16.

In the report, the Independent Expert explores the interrelationships between income and wealth inequality, on the one hand, and financial crises, on the other, and their implications for the enjoyment of human rights. He illustrates how increased levels of such inequalities may contribute to increases in sovereign debt that may subsequently degenerate into financial crises. Furthermore, he examines the reverse relationship by assessing the distributional impact of financial crises and points to severe adverse effects on the enjoyment of human rights. He concludes with a set of policy recommendations designed to target economic inequality as a pressing human rights issue and a factor contributing to the emergence of financial crises.

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Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of human rights, particularly economic, social and cultural rights

Contents

		Page
I.	Introduction	3
II.	Why must inequality be considered from a human rights perspective?	4
III.	Addressing central questions: how do inequality and debt crises interact?	8
	A. Inequality as a source of sovereign debt increase and crisis	8
	B. Impact of financial and sovereign debt crisis on inequalities	13
IV.	Conclusions and recommendations	17
	A. Conclusions	17
	B. Recommendations	18

I. Introduction

1. Severe economic inequality frequently affects the enjoyment of particular civil, political or social, economic and cultural rights as well as the principle of non-discrimination enshrined in all international human rights treaties. Human rights law imposes certain legal obligations on States to address economic inequalities affecting the enjoyment of human rights and bestows effectual guidance for reducing inequalities, including prioritization of policy responses in this field. Human rights mechanisms have therefore recently paid increased attention to economic inequality and human rights.[1]

2. Furthermore, a better understanding of the negative effects of increased economic inequality on social development has recently emerged. For example, States have made reducing inequality within and among countries Goal 10 of the Sustainable Development Goals, which includes not only the promotion of the social, economic and political inclusion of all, irrespective of age, sex, disability, race, ethnicity, origin, religion or economic or other status, but also the adoption of fiscal, wage and social policies to progressively achieve greater equality and better regulation of global financial markets and institutions.

3. Yet, there is one particular facet of inequality that has been frequently neglected: the linkages among economic inequality, financial crises and human rights. There is widespread acknowledgement that financial crises and adjustment programmes adopted in their response not only impair a country's general economic performance, but also frequently increase inequality and have a negative impact on socioeconomic outcomes and particularly on vulnerable populations. However, the notion that inequality may also be an important contributing factor to the emergence of financial crises has only recently gained wider attention. In the present report, the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, will offer reflections on both dimensions, exploring answers to the following questions: does inequality lead to more financial instability? Does financial instability lead to higher levels of inequality? What are the impacts on human rights of increased inequality? And, finally, what guidance does human rights law provide for addressing inequality?

4. In so doing, the report will be exclusively devoted to the relationship between human rights and economic inequality, and specifically income and wealth inequality. Hence, the term "inequality" employed in the report, unless otherwise qualified, should be understood as referring to these types of inequality.[2]

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[1] See, for example, the report of the Special Rapporteur on extreme poverty and human rights (A/HRC/29/31).

[2] Moreover, while both income and wealth inequality relate to economic disparities, there are important differences between the two aspects. Inequality in wealth appears to be more pronounced in many countries and in the world generally. Policy responses designed to address wealth inequality on the one hand and income inequality on the other hand may differ. Therefore, the report clearly distinguishes between those two forms of inequality where necessary. However, if such distinction is not expressly made, then the term "inequality" encompasses both forms of economic inequality.

II. Why must inequality be considered from a human rights perspective?

5. For several years, increased attention has been paid to the continued rise in income and wealth inequalities. In this context, top incomes dramatically increased from the 1980s, mostly in developed countries but also in emerging economies, such as India and China.[3] In addition to wealth transmitted through inheritance, top wages have increased dramatically, outpacing increases in average wages many times and resulting in an unprecedented accumulation of wealth by a small but powerful elite.[4]

6. Global inequality currently stands at extremely high levels and is further increasing. The United Nations Development Programme (UNDP) has reported that the richest 8 per cent of the world's population earns half of the world's total income, leaving the other half for the remaining 92 per cent.[5] Over the past two decades, income inequality has increased by 9 per cent in developed countries and 11 per cent in developing countries.[6] In 2015, the richest 1 per cent of people in the world owned more than 50 per cent of global wealth, up from 44 per cent in 2010.[7] Furthermore, the 80 richest individuals currently own as much wealth as the bottom 50 per cent of the entire global population.[8]

7. International human rights law addresses inequality on many levels. First, there are economic and social rights that clearly recognize the duties of States to address and/or prevent inequality as a threat to human rights realization. These include fundamental worker's rights — in particular the right to form and join trade unions and the right to fair remuneration — and social rights — in particular the rights to education, health and social security.[9]

8. Moreover, the principles of non-discrimination and equality apply in the context of socioeconomic disadvantages. All international and regional human rights treaties include a broadly constructed principle of non-discrimination,[10] that covers formal discrimination on prohibited grounds in law or official policy documents as well as substantive discrimination, meaning discrimination in practice and in outcomes. For example, States have certain obligations to ensure equal access to health services, adequate housing and water and sanitation.[11] The prohibition of discrimination extends not only to the grounds explicitly enumerated in article 2 (2) of the International Covenant on Economic, Social and Cultural Rights, such as race, colour, sex or religion, but also to grounds based exclusively on economic and social status.[12]

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[3] See A.B. Atkinson, T. Piketty and E. Saez, "Top income in the long run history", *Journal of Economic Literature*, vol. 49, No. 1, pp. 3-71.

[4] See T. Piketty, *Capital in the Twenty-First Century* (Cambridge, Massachusetts, Harvard University Press, 2014).

[5] See UNDP, *Humanity Divided: Confronting Inequality in Developing Countries* (New York, 2013).

[6] Ibid., p. 7, using the Gini coefficient.

[7] See "Global wealth report", Credit Suisse Research Institute, pp. 19 and 21 (2015).

[8] See "Wealth: having it all and wanting more", Oxfam issue briefing, pp. 2 and 3 (2015).

[9] See Committee on Economic, Social and Cultural Rights, general comments No. 13, para. 6 (b) (iii); No. 14, para. 19; and No. 19, paras. 16 and 25.

[10] See, for example, article 2 (1) of the International Covenant on Civil and Political Rights or article 2 (2) of the International Covenant on Economic, Social and Cultural Rights; article 14 of the European Convention for the Protection of Human Rights and Fundamental Freedoms; and article 1 (1) of the American Convention on Human Rights.

[11] See Committee on Economic, Social and Cultural Rights, general comment No. 20 (2009) on non-discrimination in economic, social and cultural rights, among other general comments.

[12] Ibid., para 35.

9. While human rights law does not necessarily imply a perfectly equal distribution of income and wealth, it does require conditions in which rights can be fully exercised. As a consequence, a certain level of distribution of resources is expected to guarantee individuals an equal enjoyment of the realization of their basic rights without resulting in discriminatory outcomes.[13] When income inequality creates discriminatory outcomes, it becomes a human rights issue. States can make an important contribution to overcoming discrimination by ensuring equal opportunity for all members of society. However, the notion of equal opportunity resembles a myth in many countries and situations, and many people in the world do not have reasonable means for overcoming socioeconomic handicaps.[14]

10. Inequality implies a violation of the rights enshrined in the Covenant when a significant number of individuals within a society cannot enjoy minimum essential levels of each of the rights enumerated in the Covenant, while other individuals within the society have more than sufficient resources available to guarantee a basic enjoyment of those rights. The violation in such cases appears to be twofold: States may fail to meet their minimum core obligations and to mobilize maximum available resources for the progressive realization of rights, as explained below.

11. According to the views of the Committee on Social, Economic and Cultural Rights, when a significant number of individuals living in a State party are deprived of critical foodstuffs, essential primary health care, basic shelter and housing or the most indispensable forms of education, there is a prima facie case of failing to discharge its obligations under the Covenant.[15] It should be noted that the minimum income necessary for the enjoyment of such essential levels of economic, social and cultural rights may differ from one individual to the other — an aged and sick person may potentially need more resources to enjoy effective access to adequate health care and medication than a healthy young person — and from one country to the other. In essence, international human rights norms require States to ensure that all persons residing in their territory live in conditions of dignity.

12. States are furthermore obliged to use maximum available resources for the progressive realization of economic, social and cultural rights. Progressive realization implies that States have to ensure the enjoyment of minimum essential levels of rights on a non-discriminatory basis first and without retrogression. It is the view of the Independent Expert that States may also fail to use their maximum available resources if they neglect to undertake reasonable efforts to ensure domestic revenue generation and redistribution to address income inequality that violates human rights, such as if a State fails to address inequality through appropriate taxation or social policies.[16]

13. To reduce the concept of "maximum available resources" to only those resources on the balance sheet of the treasury would be contrary to the purpose of the Covenant and the Universal Declaration of Human Rights, which guarantees to every person a life in dignity and freedom from fear and want. Maximum available resources also encompass those

[13] See R. Balakrishnan, J. Heintz and D. Elson, "What does inequality have to do with human rights?", Political Economy Research Institute, Working Paper Series No. 392 (2015), p. 16.

[14] J.E. Stiglitz, *The Price of Inequality: How Today's Divided Society Endangers Our Future* (New York, W.W. Norton and Company, 2012), p. 18.

[15] See Committee on Economic, Social and Cultural Rights, general comment No. 3 on the nature of States parties' obligations, para. 10.

[16] See "Política fiscal y derechos humanos en las Américas: movilizar los recursos para garantizar los derechos", thematic report submitted by civil society organizations to the Inter-American Commission on Human Rights, October 2015. Available in Spanish from www.cesr.org/downloads/cidh_fiscalidad_ddhh_oct2015.pdf.

resources that a State can reasonably generate through adequate, appropriate and fair taxation of individuals and corporations or through the levying of tariffs.

14. In addition, it should be noted that article 2 (1) of the Covenant explicitly refers to those resources that can be made available through international assistance and cooperation, in particular economic and technical assistance. It also extends to an obligation to create an international enabling environment conducive to the universal fulfilment of human rights. This international terrain includes bilateral and multilateral trade, investment, taxation, finance, environmental protection and development cooperation. In other words, human rights law requires a certain degree of redistribution of resources and support based on available capacities within and among nations. This encompasses an organization of the local and global economies that prevents and eradicates extreme poverty.[17] Violations of this principle are pervasive: With 795 million people worldwide being undernourished, at least one out of nine persons on Earth is currently excluded from enjoying essential minimum levels of the right to food.[18] The United Nations Human Settlements Programme has estimated that close to one billion people currently do not have adequate housing but instead often live in informal settlements in developing countries.[19] Inequalities within and among nations are an important contributing factor to these unsettling outcomes. Inequality is both a cause and a symptom of massive violations of economic, social and cultural rights.

15. Economic inequality also matters from a human rights perspective when it translates into other types of inequalities. The enjoyment of human rights does not depend only on access to goods and services reflecting the minimum needed for survival; an individual's access to resources relative to others is also of crucial importance. Data suggests that high levels of relative inequality may have substantial negative effects on the practice of human rights. It has been observed that low-income households in a very unequal society may do worse than households with the identical income in a more equal society.[20] This pattern is obvious in numerous areas, including legal representation, education, political influence, health, housing and social discrimination that can escalate into conflict.

16. To illustrate, a poor domestic worker may not be able to sue his or her employer to challenge an unfair unilaterally imposed pay cut, both because labour rights may not be institutionalized in the State and because legal representation is not affordable. Continuing to work in unfair conditions or quitting the job may be the only viable options, which is a choice that can beget oppression, particularly when market conditions of high unemployment make replacing employees rather easy.

17. Likewise, people in poverty may not be able to afford higher education because of prohibitively high tuition fees, the need to work for immediate income and the inability to

[17] See principle 29 of the Maastricht Principles on Extraterritorial Obligations of States in the Area of Economic, Social and Cultural Rights.

[18] See Food and Agriculture Organization of the United Nations (FAO), *The State of Food Insecurity in the World. Meeting the 2015 international hunger targets: taking stock of uneven progress* (Rome, 2015), p. 8. FAO employs a narrow definition of undernourishment, which has faced heavy criticism for masking the magnitude of the hunger problem, see F.M. Lappé et al., "How we count hunger matters", Ethics and International Affairs, vol. 27 No. 3 (2013), pp. 251-259.

[19] See http://mirror.unhabitat.org/content.asp?cid=11848&catid=746&typeid=24&subMenuId=0.

[20] See R. Balakrishnan, J. Heintz and D. Elson, "What does inequality have to do with human rights?", Political Economy Research Institute, Working Paper Series No. 392 (2015). See also R. Wilkinson and K. Pickett, *The Spirit Level: Why More Equality Societies Almost Always Do Better* (New York, Bloomsbury Press, 2009).

move themselves out of unskilled positions, which can also become a multigenerational trap.[21]

18. It is also common for poorer segments of the population to be marginalized or even effectively excluded from the political process. As noted by the Special Rapporteur on extreme poverty and human rights, Philip Alston, economic and social inequalities often reinforce one another "when individuals with higher incomes or their family members have more political power or access to better education than those with lower incomes".[22] In failing to recognize the connection between social and economic inequalities, there is a risk of political capture of the political system by economic elites, effectively undermining the right to vote and the principle of democracy.

19. Equally significant is that those on the high end of the income and wealth divide become less dependent on public goods and services because they have the means to purchase private alternatives. At the same time, the poor are getting more dependent on public services, as private alternatives become less affordable for them. As soon as the more affluent and powerful groups in society cease to depend on public goods and services, the State is less likely investing in public, collective goods, leading to a vicious circle of their degeneration.

20. Moreover, countries suffering from high levels of inequality have worse health outcomes compared to other countries with a similar gross domestic product (GDP).[23] For example, there is a strong positive correlation between rates of child mortality and inequality among countries at similar levels of development. Also, inequality may impair the availability of adequate housing for low-income households.[24]

21. Inequality often contributes to social exclusion and marginalization of certain groups and individuals. In addition, if inequality entrenches social cleavages along regional, religious, racial or ethnic lines, social instability and violent internal conflict are more frequent.[25] It has recently been noted that "[w]hen the poor are from one race, ethnicity, religion or region and the rich are from another, a lethal, destabilizing dynamic often emerges".[26] Inequality not only increases the risk of economic and social rights violations, but also augments the likelihood of severe violations of civil and political rights.[27]

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[21] For more information on the negative effect of income inequality on the right to education, see the report of the Special Rapporteur on extreme poverty and human rights (A/HRC/29/31, para. 30).

[22] Ibid., para. 6.

[23] See R. Wilkinson and K. Pickett, *The Spirit Level: Why More Equality Societies Almost Always Do Better* (New York, Bloomsbury Press, 2009).

[24] See J. Matlack and J. Vigor, "Do rising tides lift all prices? Income inequality and housing affordability", *Journal of Housing Economics*, vol. 17, No. 3 (2008), pp. 212-224.

[25] See L.E. Cederman, N.B. Weidmann and K. Skrede Gleditsch, "Horizontal inequalities and ethnonationalist civil war: a global comparison", *American Political Science Review*, vol. 105, No. 3 (2011), pp. 487-89.

[26] See M.W. Doyle and J.E. Stiglitz, "Eliminating extreme inequality: a sustainable development goal, 2015-2030", *Ethics and International Affairs*, vol. 28, No. 1 (2014).

[27] See T. Landman and M. Larizza, "Inequality and human rights: who controls what, when, and how", *International Studies Quarterly*, vol. 53, No. 3 (2009), pp. 715-736.

III. Addressing central questions: how do inequality and debt crises interact?[28]

A. Inequality as a source of sovereign debt increase and crisis

22. Inequality may affect sovereign debt both directly and indirectly. In short, the direct impact proceeds from the "corrosive" influence of inequality on the tax base, as well as from its enhancing effect on demand for redistribution through debt default. As for the indirect impact, it is mainly private debt that acts as an interface between inequality and sovereign debt. Increasing inequality may lead to private overborrowing and overlending. The resulting excessive private leverage can accumulate over many years, destabilize the financial system[29] and even become so volatile for the economy that the debt can trigger a banking crisis, leading to both output losses and massive bailout costs for Governments. In addition, both the direct and the indirect channel may simultaneously prompt a currency crisis if external debt is involved.

1. Inequality as a direct cause of sovereign debt increase and financial crises

23. Inequality may exert a considerable direct influence on the structure and the level of government revenues and spending. Increased levels of inequality also mean that the income tax base of the State concerned is rather small, at least if income taxation is not progressive. This diminishes sovereign revenues and consequently makes the State more dependent on borrowing. Thus inequality contributes in many cases to sovereign debt, which may eventually result in sovereign default and financial crises. There is a growing body of evidence for this mechanism.

24. Empirical studies point to a clear nexus between inequality, income tax base and sovereign debt. One study, using data from 50 countries in 2007, 2009 and 2011, found a negative correlation between income inequality and the tax base and a positive correlation with sovereign debt.[30] An analysis of a panel of 17 countries of the Organization for Economic Cooperation and Development (OECD) covering the period 1974-2005 found a positive correlation between the top 1 per cent income share, a widely used indicator of income inequality, and fiscal deficit.[31] The erosion of the income tax base following an increase in inequality is also likely to affect the structure of tax revenue. The alternative to experiencing a fiscal deficit would be to increase other types of taxes, such as import or export duties and indirect or corporate taxes. This would, however, lead to higher revenue volatility, consequently increasing the risk of sovereign debt crisis.

25. Increased inequality is also found to contribute to the degeneration of sovereign debt into sovereign debt crises. A number of studies show that high inequality increases the

[28] For a detailed overview of the interrelationships between inequality and financial crises, see R. Bazillier and J. Hericourt in "The circular relationship between inequality, leverage and financial crisis", Laboratoire d'Economie d'Orléans, (University of Orleans, 2015). The Independent Expert wishes to thank the authors of that article for having prepared a background research paper for the present report.

[29] See M. Kumhof, R. Ranciere and P. Winant, "Inequality, leverage and crises", *American Economic Review*, vol. 105, No. 3 (2015), pp. 1217-1245.

[30] See J. Atzenman and Y. Jinjarak, "Income Inequality, Tax Base and Sovereign Spreads", *FinanzArchiv: Public Finance Analysis*, vol. 68, No. 4 (2012), pp. 431-444.

[31] See S. Milasi, "Top income shares and budget deficits", Centre for Economic and International Studies, Research Paper Series, vol. 10, issue 11, No. 249 (August 2013).

probability of default significantly.[32] In one research paper, it was emphasized that sudden, rapid rises in inequality, in particular, can considerably increase the sovereign default risk. The authors specify that such "inequality shocks" generate a far higher probability of default than collapses of domestic production of the same scale.[33] Several authors have also established that progressive income taxes, which decrease income inequality, can decrease the default risk.[34]

26. One explanation for these links focuses on the incentives of the government to reap the short-term gains of a default. By defaulting, the government may obtain new fiscal freedom — even if this freedom might be short-lived — permitting tax cuts or spending increases to the benefit of the poorer. These benefits are considered greater in more unequal societies with a larger number of low-income households.[35] At the same time, owing to the higher probability that a government in highly unequal States may decide to default, lenders may accept only lower levels of aggregate debt before they sharply raise interest rates or even refuse to issue further credit.[36] According to some authors, the levels of debt lenders deem acceptable differ for domestic and foreign debt, the letter being decidedly lower.[37] This indicates that external debt is per se an important factor that may cause sovereign default.

27. Yet, in the long run, default normally implies future costs owing to a (temporary) exclusion from financial markets. As the government cannot use any more debt to smooth taxes, it is forced to adjust its tax revenues to any short-term fluctuation. The resulting volatile taxation harms poorer households in particular. The more numerous they are, the larger the future costs of default therefore become. However, the incentives to default tend to dominate the second in very unequal societies; hence, economies with more progressive taxation have less incentive to default.

2. Inequality as an indirect cause of sovereign debt increase and financial crises

28. Inequality can also indirectly contribute to increased sovereign debt and consequently to sovereign debt crises. There are at least two avenues to such outcomes: (a) high levels of inequality contribute significantly to the generation and increase of private debt, with strong interrelationships between excessive private debt, sovereign debt and financial crises; and (b) inequality adversely affects social and political stability, thereby hampering growth and eventually affecting both government revenue and spending.

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[32] See A. Berg and J. Sachs, "The debt crisis structural explanations of country performance", *Journal of Development Economics*, vol. 29, No. 3 (1988), pp. 271-306; J. Sachs, "The debt overhang of developing countries", *Debt, Stabilization and Development: Essays in Memory of Carlos Diaz Alejandro* (Oxford, 1989) and the papers referred to in footnotes 33-37.

[33] See K. Jeon and Z. Kabukcuoglu, "Income inequality and sovereign default", working paper (University of Pittsburgh, 2015).

[34] Ibid.; see also A. Ferriere, "Sovereign default, inequality and progressive taxation", job market paper (New York University, 2014).

[35] See A. Ferriere, ibid.; and Y.K. Kim, "Inequality and sovereign default under democracy", *European Journal of Economic and Political Studies*, vol. 6, No. 1 (2013), pp. 5-40. It is important to note that a default does not imply per se negative consequences for the population. It is mainly the fiscal retrenchment following the default — because the government cannot anymore borrow on financial markets — which impacts negatively the people's human rights.

[36] See A. Dovis, M. Golosov and A. Shourideh, "Political economy of sovereign debt: cycles of debt crisis and inequality overhang", mimeo (2015).

[37] See C.M. Reinhart, K.S. Rogoff and M.A. Savastano, "Debt intolerance", *Brookings Papers on Economic Activity*, vol. 34, No. 1 (Brookings Institution, 2003), pp. 1-74.

Interrelationships between private debt, sovereign debt and financial crises

29. A boom in private debt is usually considered a more accurate predictor of financial instability than the level or development of sovereign debt.[38] However, sovereign debt may be, depending on the circumstances, a major factor for triggering or worsening financial crisis. For example, excessive sovereign debt in some countries has been a prominent contributor to the recent global financial crisis. Public and private debts are linked in many ways, often reinforcing the other's negative effects, which may be described as a diabolical loop between both.[39] Even when financial crises are not necessarily driven by public debt, such debt has an impact on the aftermath of crises, leading to more prolonged periods of economic depression.[40]

30. The consequences of a financial crisis on public finances are immense. Nationalization of private debts along with bailout and recapitalizing costs for the banking system have contributed to an explosion of sovereign debt. Even more important factors to the aggregation of sovereign debt are generally the fall in production, the consecutive contraction in the tax base and countercyclical policies set to fight the downturn resulting in higher government spending. If the country instead uses consolidation policies to reduce its debt, this often turns out counterproductive because of a negative impact of reduced government spending on economic growth and employment, as the International Monetary Fund (IMF) has recently acknowledged.[41]

31. There are several channels through which inequality affects private debt and financial crises. As a starting point, it is noteworthy that household debt and top income share — a standard indicator of inequality — are strongly correlated: in many countries, household debt and top income share have grown simultaneously and at similar pace over many years.[42] Recent research has focused on credit demand and supply channels for explaining the nexus between private debt and inequality.

32. According to the credit-demand line of reasoning, private debt increases as households try to maintain certain absolute or relative levels of consumption, while facing growing inequality.[43] In other words, people borrow more extensively to maintain their absolute or relative standard of living. Data collected for the United States of America confirm this interpretation: a study from 2006 revealed that, over the previous 25 years, income inequalities in the United States had increased without being followed by an increase in consumption inequalities.[44] Some explain this as a result of a higher dispersion of transitory income, but it appears likely that massive permanent income shifts play a more

[38] See M. Schularik and A.M. Taylor, "Credit booms gone bust: monetary policy, leverage cycles and financial crises, 1870-2008", *American Economic Review*, vol. 102, No. 2 (2012), pp. 1029-1061.

[39] See M. Brunnermeier et al, "European Safe Bonds" (Euro-nomics group, 2011).

[40] See O. Jorda, M. Schularick and A.M. Taylor, "Sovereigns versus banks: credit, crises and consequences", working paper No. 19506 (National Bureau of Economic Research, 2013).

[41] See IMF, *World Economic Outlook 2012: Coping with High Debt and Sluggish Growth*, World Economic and Financial Surveys (Washington, D.C., 2012); and N. Batini, L. Eyraud, L. Forni and A. Weber, "Fiscal multipliers: size, determinants and use in macroeconomic projections", IMF technical notes and manuals No. 14) (Washington, D.C., 2014).

[42] See Bazillier and Hericourt, "The circular relationship between inequality, leverage and financial crisis" (footnote 28).

[43] See J.K. Galbraith, *Inequality and Instability, A Study of the World Economy Just Before the Great Crisis* (Oxford, 2012).

[44] See D. Krueger and F. Peri, "Does income inequality lead to consumption inequality? Evidence and theory", *Review of Economic Studies*, vol. 73, No. 1 (2006), pp. 163-193.

prominent role here.[45] In particular, the observation that the debt-to-income ratio of the top 5 per cent and bottom 95 per cent households has undergone a dramatic reversion between 1983 and 2007 supports the latter view.[29] Also, a negative link between income inequality and social mobility was found by analysing a sample of 16 countries.[46] For numerous developing and developed countries, it has also been shown that the increase in inequality was mainly due to an increase in between-group inequality, reflecting permanent income shocks.[47] Explanations for persistent borrowing by low- and middle-income households despite growing income inequality can be found in several variants of the relative income hypothesis, according to which household consumption is a function of the household's position in the income distribution and its past levels of consumption.[48]

33. Another theory connects inequality, credit demand and monetary policy. It holds that highly unequal income distribution leads to overreliance on investment and luxury consumption. This may not be sufficient for a sustainable level of economic output, prompting low interest rates which itself allows private debt to increase beyond sustainable levels.[49]

34. In turn, the rise in the incomes of the richest will also increase their savings, leading to a huge accumulation of private wealth. This rising supply of capital requires more investment opportunities and consequently boosts the credit supply, even for riskier borrowers.[50] Moreover, a possible consequence of this accumulation of private wealth is creditor-led lobbying to favour policies that may lead banks to issue risky loans and eventually to a massive distribution of subprime loans to low income individuals. It has been argued that "growing income inequality in the United States ... led to political pressure for more housing credit", which eventually "distorted lending in the financial sector".[51]

35. It seems likely that the credit demand and credit supply channel are activated simultaneously. Other factors also play an important role.[52] A general shift towards a

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[45] See R.A. Moffitt and P. Gottschalk, "Trends in the transitory variance of male earnings in the United States, 1970-2004", working paper No. 16833 (National Bureau of Economic Research, 2011); and M. Iacoviello, "Household debt and income inequality, 1963-2003", *Journal of Money, Credit and Banking*, vol. 40, No. 5 (2008), pp. 929-965.

[46] See D. Andrews and A. Leigh, "More inequality, less social mobility", Applied Economics Letters, vol. 16, No. 15 (2009), pp. 1489-1492.

[47] Ibid; see also R. Kanbur, C. Rhee and J. Zhuang, "Rising inequality in Asia and policy implications", macroeconomics working paper No. 23973 (East Asian Bureau of Economic Research, 2014).

[48] See T. van Treeck, "Did inequality cause the United States financial crisis?", *Journal of Economic Survey*, vol. 28 No. 3 (2014), pp. 421-448; and R.H. Frank, A.S. Levine and O. Dijk, "Expenditure cascades", *Review of Behavioral Economics*, vol. 1, Nos. 1 and 2 (2014), pp. 55-73.

[49] See J.-P. Fitousso and F. Saraceno, "How deep is a crisis? Policy responses and structural factors behind diverging performances", working document No. 2009-31 (Observatoire français des conjonctures économiques, 2009); and A.B. Atkinson and S. Morelli, "Economic crises and inequality", Human Development Research Paper No. 2011/06, (United Nations Development Programme, 2011).

[50] See P. Lysandrou, "Global inequality, wealth concentration and the subprime crisis: a Marxian commodity theory analysis", *Development and Change*, vol. 42, No. 1 (2011), pp. 183-208. See also M. Kumhof et al, "Inequality, leverage and crises" (footnote 29).

[51] See R.G. Rajan, Fault Lines: How hidden fractures still threaten the world economy, (Princeton, 2010); see also Galbraith, *Inequality and Instability* (footnote 43).

[52] See Bazillier and Hericourt, "The circular relationship between inequality, leverage and financial crisis" (footnote 28).

radical free-market stance,[53] the prevalent finance-led model of growth and the accompanying deregulation of the financial sector even seem to be main factors explaining the global financial and economic crises that began in 2007, which is often labelled the "Great Recession".[54] The decline of workers' bargaining power owing to labour market flexibility and wage moderation has possibly contributed to the demand side described above. Financial liberalization and deregulation explain, besides the growing wealth at the top, increased credit supply.[55]

36. Based on the theoretical considerations above, it is not surprising that an examination of 18 OECD countries over the period 1970-2007 revealed a positive link between income inequality and credit growth.[56] Moreover, over the period 1980-2010, a large majority of banking crises were preceded by persistently high levels of income inequality.[57] Concerning the United States specifically, one study that investigated the period 1980-2003 found a "strong positive effect of income inequality in household debt relative to disposable income as well as the components of the household debt (mortgage debt, revolving debt, e.g. credit cards, and non-revolving debts, e.g. car loans)".[58] Although these results seem to confirm the theoretical ideas above, it should be noted that more empirical research is needed.

Impact of inequalities on social and political stability and growth

37. Inequality may also reduce social and political stability. This creates disincentives for investment, disruptions in business activity, disunity,[59] threats to property and policy uncertainty and may even raise the probability of coups and mass violence. The result is a lower level of growth, which consequently provokes higher level of debt. The link between inequality, political instability and investment has been confirmed by an empirical study made on 70 countries over the period 1960-1985.[60]

38. Recent cross-country evidence supports the notion that inequality reduces economic growth. Based on vast data for both OECD and emerging countries, an IMF study from

[53] See P. Krugman, "Inequality and Crises", New York Times blog "The Conscience of a liberal", (June 2010), http://krugman.blogs.nytimes.com/2010/06/28/inequality-and-crises.

[54] See Galbraith, *Inequality and Instability* (footnote 4343. He also identifies mainly financial forces as the source of growing inequality.

[55] See P. Tridico, "Financial crisis and global imbalances: its labor market origins and the aftermath", *Cambridge Journal of Economics*, vol. 36, No. 1 (2012), pp. 17-42.

[56] See C. Perugini, J. Hölscher and S. Collie, "Inequality, credit and financial crises", *Cambridge Journal of Economics* (2015), available from http://cje.oxfordjournals.org/content/early/2015/01/05/cje.beu075.full.

[57] See G. Bellettini and F. Delbono, "Persistence of high income inequality and banking crises: 1980-2010", working paper No. 885 (University of Bologna, Department of Economics, 2013). By contrast, works by A.B. Atkinson and S. Morelli come to inconclusive results, both for increases and levels of inequalities; see "Income inequality and banking crisis: a first look", report prepared for the Global Labor Forum 2011 (International Labour Organization (ILO), Turin, 2010) and "Inequality and crises revisited", working paper No. 387 (Centre for Studies in Economics and Finance, University of Naples, 2015). They also provide for possible explanations for their outcomes, in particular the choice of inequality measures and contagion between national economies due to globalization.

[58] See M. Christen and R. Morgan, "Keeping up with the Joneses: analyzing the effect of income inequality on consumer borrowing", *Quantitative Marketing and Economics*, vol. 3, No. 2 (2005), pp. 145-173, at 148.

[59] See K.H. Park, "Income inequality and economic progress: an empirical test of the institutionalist approach", *American Journal of Economics and Sociology*, vol. 55 No. 1 (1996), pp. 87-97.

[60] See A. Alesina and R. Perotti, "Income distribution, political instability, and investment", *European Economic Review*, vol. 40 No. 6 (1996), pp. 1203-1228.

2014 provides a solid case that lower inequality is robustly correlated with faster and more durable growth.[61] A further IMF study supports these conclusions using a sample of 159 advanced, emerging and developing economies. The authors conclude that the income distribution itself matters for growth. Specifically, if the income share of the top 20 per cent increases, then GDP growth actually declines over the medium term, suggesting that the benefits do not trickle down. In contrast, an increase in the income share of the bottom 20 per cent is associated with higher GDP growth.[62]

B. Impact of financial and sovereign debt crisis on inequalities

39. Financial crises generally have enormous distributional consequences, originating in several factors.

1. Decline in economic output

40. To start with, financial crises may massively hamper economic growth, principally because of decline in investment in production, as a result of credit contraction. Banking crises usually lead to a significant output drop. On average, the real per capita GDP drop amounts to over 9 per cent, with a recovery time of two years.[63] An analysis of financial crises, taking into account both banking and currency crises, has revealed that the average output loss is 20 per cent of GDP, with a recovery time of three to four years.[64] However, isolated currency crises as such may have mixed effects: they usually increase the price of imported goods and may lead to a contraction of available credit, considerably encumbering growth. At the same time, currency crises may also benefit the exporting sector of a country.

41. The consequences of sovereign-debt crisis on economic growth are difficult to isolate, as they are generally preceded by or coincide with banking crises. However, there is a strong negative correlation between extreme levels of sovereign debt or sovereign default on the one hand and growth on the other. One study, for example, has found that debt crises lead to significant and long-lasting output losses, reducing output by about 10 per cent after eight years.[65]

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[61] See J. Ostry, J. Berg and C.G. Tsangarides, "Redistribution, inequality and growth", IMF staff discussion note No. 14/02 (2014).

[62] See E. Dabla-Norris et al, "Causes and consequences of income inequality: a global perspective", IMF staff discussion note No. 15/13 (2015).

[63] See C.M. Reinhart and K.S. Rogoff, "The aftermath of financial crises", *American Economic Review*, vol. 99 No. 2 (2009), pp. 466-72.

[64] See M.D. Bordo et al, "Is the crisis problem growing more severe?", *Economic Policy* Vvl. 16 No. 32 (2001), pp. 51-82. The authors also demonstrate that banking and currency crises have become more frequent in the last quarter of the twentieth century.

[65] See D. Furceri and A. Zdzienicka, "How costly are debt crises?", *Journal of International Money and Finance*, vol. 31, No. 4 (2012), pp. 726-742; see also F. Sturzenegger, "Toolkit for the analysis of debt problems", *Journal of Restructuring Finance*, vol. 1 No. 1 (2004), pp. 201-03; and B. De Paoli, and G. Hoggarth, "Costs of sovereign default", *Bank of England Quarterly Bulletin*, (Q3, 2006), finding negative correlations between sovereign default and growth. Although some researchers interpret sovereign default as the beginning of economic recovery, for example, E. Levy Yeyati and U. Panizza, "The elusive costs of sovereign defaults", *Journal of Development Economics*, vol. 94 No. 1 (2011), pp. 95-105, this does not contradict the finding that high increasing levels of sovereign debt may hamper economic growth, as "the anticipation of a default causes low growth", *ibid.*

2. Inflation, unemployment and labour share

42. In addition to this slowdown in economic activity, there are several other channels through which financial crises affect income and wealth distribution. Currency crises exert their influence by leading to relative price changes, fiscal retrenchment and changes in assets.[66] Devaluation leads to the aforementioned fall in earnings of those employed in the non-tradable sector, while it increases the demand for exports and therefore may benefit employment and earnings in this sector. The poor may also be affected by the price increase of imported goods, especially food prices. Fiscal retrenchment and public spending cuts may affect social assistance outlays, amplifying the consequences of the crisis on the poor. Lastly, changes in the value of assets have an impact on income distribution because variations in interest rates, assets and real estate prices are more likely to affect the wealth of the better off.

43. In the aftermath of banking crises, the associated unemployment rate rises on average by about 7 percentage points, with a duration of over four years.[67] Currency crises also affect the labour share of income.[68] The labour share is a key indicator for the distribution of income in a country: it shows how much of national income is distributed to labour and how much to capital. Currency crises are associated with a strong fall of the labour share, which is only partially compensated in the following years. Even the long-term trend of declining labour share that has been observed for decades may at least partly be explained by financial crises. This implies consistently growing income inequality, as a falling labour share means that an ever larger share of the benefits of growth accrues to owners of capital. This development may be even more significant in developing countries, where a large share of the capital is held by foreigners.[69]

3. Growth in poverty

44. In total, currency crises have a magnifying impact on both the spread of poverty and inequality. Based on the Gini coefficient, one particular study found inequality to increase by 0.63 per cent relative to the pre-crisis year. Moreover, the association between crises and income distribution/poverty was stronger when crises were followed by average income losses. This fall of income accounted for 15-30 per cent of the variations in the poverty and inequality indicators. The study also found a more-than-proportional fall in the income share of the lowest income quintiles and an increase in the income share of the highest quintile.[70] Another study concluded that on the average inequality rises by 16.2 per cent in the two-year period immediately following a currency crisis as opposed to 3.2 per cent in years without crises.[71] The Great Recession, best described as a systemic banking crisis, which has been followed by a debt crisis, especially in the European Union, has led to

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[66] See E. Baldacci, L. de Mello and G. Inchauste, "Financial crises, poverty and income distribution", IMF working paper No. 02/4 (2002).

[67] See C.M. Reinhart and K.S. Rogoff, "The aftermath of financial crises", *American Economic Review*, vol. 99 No. 2 (2009), pp. 466-72.

[68] See R. Bazillier and B. Najman, "Labour and Financial Crises: Is Labour paying the price of the crisis?", mimeo (2012).

[69] See I. Diwan, "Debt as sweat: labor, financial crises, and the globalization of capital", mimeo (Washington, D.C., World Bank, 2001); and P. Maarek and E. Orgiazzi, "Currency crises and the labor share", *Economica* vol. 80, No. 319 (2013), pp. 566-588.

[70] See Baldacci et al, "Financial crises, poverty and income distribution", (footnote 66).

[71] See J.K. Galbraith and L. Jiaquing, "Inequality and financial crises: some early findings", working paper No. 9 (University of Texas, 1999), using the Theil Index, another inequality indicator.

massive inequality jumps. Using the ratio 90 to 10 as a proxy of inequality, United States income inequalities have risen by 11 per cent between 2007 and 2011.[72]

45. When assessing the impact of financial crises on inequality, it is necessary to keep two aspects in mind that may lead to distortions of the outcomes. First, poverty rates may only be a limited indicator of the scope of the problem, as the number of people falling into poverty and escaping poverty over the same period may surge, increasing the depth of poverty, while the poverty rate remains stable. Second, top income earners may experience a decrease of their revenues in the short run owing to a crisis because of their higher dependence on capital income. This may explain why the distributional effect of crises is not always clear in the very short run.

4. Structural factors mitigating social impacts, labour regulations and safety nets

46. However, other factors have significant influence on the size of the effects of financial crises. For example, it appears that crises raise inequalities more in the most deregulated labour markets, and financial crises have had worse effects on Latin American workers than on Asians, and stronger adverse impacts on Asians than on the organized workers of Northern economies.[73] This finding suggests that there is a crucial interaction between labour market institutions and the specific effects of financial crises.

47. One should also note that the impact of crises on inequalities depends on the existing social protection system in the country, as well as the level of public spending, which serves as an automatic stabilizer during a recession. Experiences in the OECD support this notion: during the period 2007-2009, in the OECD, the household sector in the aggregate appears to have been well protected from the impact of the downturn. This was possible because of government intervention through tax and benefit systems in most countries.[74] However, consolidation policies implemented after 2010 are likely to have a greater effect on income distribution.[75]

5. Impacts of government responses to crises (fiscal consolidation)

48. In most countries, financial crisis is followed by fiscal consolidation, which may also have a strong distributional impact. Several studies on OECD countries and other emerging and advanced economies have demonstrated that fiscal consolidation is usually associated with a rise of inequalities, a fall of the labour share and a rise of long-term unemployment.[76] One study came to the conclusion that 15-20 per cent of the increase in inequality following a fiscal consolidation is explained by the rise of unemployment.[77] Social spending cuts are another substantial contributor to rising inequalities. A 1 per cent decrease in social spending is associated with a rise of 0.2-0.7 per cent in inequality.[78] Crises usually have strong effects on social spending, with lowest income countries being

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[72] See B.D. Meyer and J.X. Sullivan, "Consumption and income inequality and the great recession", *American Economic Review*, vol. 103, No. 3 (2013), pp. 178-83.

[73] Ibid., p. 7.

[74] See S.P. Jenkins et al. *The Great Recession and the Distribution of Household Income* (Oxford, Oxford University Press, 2013).

[75] Ibid.

[76] See L. Ball et al, "The distributional effects of fiscal consolidation", IMF working paper No. 13/151 (Washington, D.C., 2013); J. Woo et al, "Distributional effects of fiscal consolidation and the role of fiscal policy: what do the data say?" IMF working paper 13/195 (Washington, D.C., 2013).

[77] J. Woo et al, "Distributional effects of fiscal consolidation (footnote 76).

[78] *Ibid.*

more likely to cut social spending during crises.[79] The Great Recession, for example, has led to broad and deep cuts in social security spending.[80]

49. As to debt crises, it is challenging to disentangle the specific effects of default from those of the stabilization policies, such as those that tend to follow IMF interventions in developing countries. What seems clear is that IMF programmes are associated with a worsening of income distribution and a reduction in the incomes of the poorest citizens when external imbalances were high prior to the programme. These programmes may only decrease income inequality when external imbalances are less severe.[81]

50. Dynamics of inequalities in Latin America in the 1980s offer good insights into the potential distributive impact of debt crises. A study on this region during that decade provided strong evidence confirming that income inequality "mirrors the economic cycle, rising during recessions".[82] The costs of the crises have not been borne equally[83] and most adjustment programmes resulted in "overkill" leading to increases in poverty and inequality beyond what was necessary (and legal).[84]

6. Social impact of financial crises

51. Financial crises and the austerity measures adopted in response also have a robust negative social impact that, in turn, perpetuates or exacerbates inequality. The organization Caritas has summarized that the situation of many households in Europe "remains serious, as poverty and social exclusion are rising in most member States, affecting particularly the working age population and, consequently, children. Young people are seriously affected by labour market exclusion: nearly a quarter of economically active young people in the European Union are unemployed".[85] In a study, OECD notes that "the numbers living in households without any income from work have doubled in Greece, Ireland and Spain. Low-income groups have been hit hardest, as have young people and families with children".[86] The study also points out the adverse long-term impact of the Great Recession on families, fertility and health. Drops in fertility rates have already been observed. Families have cut back essential spending, compromising their current and future well-being. Furthermore, although it is too early to assess the overall impact on health, unemployment and connected economic difficulties are known to increase health problems, including mental illness. Cutbacks in social protection are also likely to increase health problems. As an illustration, Oxfam reports that 20 per cent of pharmacy clients in Lisbon

[79] See M. Lewis and M. Verhoeven , "Financial crises and social spending: the impact of the 2008-2009 crisis", Other Operational Studies No. 12965 (Washington, D.C., World Bank, 2010).

[80] See F. Bonnet, E. Ehmke and K. Hagemejer, "Social security in times of crisis" *International Social Security Review*, vol. 63, No. 2 (2010), pp. 47-70, at. 48.

[81] See M. Pastor, "The effects of IMF programs in the third world: debate and evidence from Latin America", *World Development*, vol. 15, No. 2 (1987), pp. 249-262; and G. Garuda, "The distributional effects of IMF programs: a cross-country analysis", *World Development*, vol. 28 No.6 (2000), pp. 1031-1051.

[82] See G. Psacharopoulos et al, "Poverty and income inequality in Latin America during the 1980s", *Review of Income and Wealth*, vol. 41 No. 3 (1995), pp. 245-264.

[83] See N. Lustig, "The 1982 debt crisis, Chiapas, NAFTA, and Mexico's poor", *Challenge*, pp. 45-50 (1995).

[84] See L. Gasparini and A. L. Lustig, "The rise and fall of income inequality in Latin America", working paper of the Center for Distributive, Labor and Social Studies (2011).

[85] "Poverty and inequality on the rise", Caritas crisis monitoring report 2015, p. 29.

[86] See OECD, *Society at a Glance 2014: OECD Social Indicators* (Paris, 2014), available from http://dx.doi.org/10.1787/soc_glance-2014-en.

did not complete their whole prescriptions owing to rising costs.[87] In a case study on Greece, Oxfam reports a strong impact of increased poverty and inequality on crime and suicide rates.[88] In Spain, meanwhile, a harsh set of austerity measures has driven a dramatic uptick in unmet health needs among the poor, wage precariousness, income inequality and poverty, especially among children.[89]

52. Similarly, several United Nations bodies have identified the social impact of debt crises and related structural adjustment programmes.[90] Studies by the United Nations Children's Fund (UNICEF) have demonstrated that debt-servicing obligations diverted cash from social welfare programmes with adverse consequences on human development.[91] Austerity measures have exacerbated the negative social impact for disadvantaged groups such as women, children, person with disabilities, older persons, people with HIV/AIDS, indigenous peoples, ethnic minorities, migrants, refugees and the unemployed, as documented in a report of the Office of the United Nations High Commissioner for Human Rights in 2013.[92] Overall, adjustment plans without consistent debt reliefs have proven to be detrimental to human development and human rights, at least in the short term. Alternatively, substantial debt relief has allowed targeted countries to scale up "poverty-reducing" expenditures.[93]

IV. Conclusions and recommendations

A. Conclusions

53. **The present report demonstrates that there are manifold linkages between inequality, private and sovereign debt and the occurrence of financial crises. Although economic research only recently has turned to this field and many aspects still need to be examined, a number of important outcomes appear to be established at this stage. First, there are strong indications that inequality may substantially contribute to and exacerbate the emergence and the course of financial crises, even if other factors, in particular financial deregulation, obviously also play a crucial role. Inequality erodes States' tax base, thereby impacting sovereign revenues. Inequality also appears to prompt increased levels of private credit, which in turn may adversely affect sovereign debt and stability of the financial markets. This phenomenon is mainly explained by rising credit demand and credit supply. Aggregate underconsumption in conjunction with corresponding low interest monetary policy may be a contributing factor to an increased credit supply.**

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[87] See T. Cavero and K. Poinsasamy, "A cautionary tale: the true cost of austerity and inequality in Europe", Oxfam briefing paper (2013).

[88] See G. Cavero, "The true cost of austerity and inequality in Europe – Greek case study", Oxfam case study (2013).

[89] See "Visualizing rights: a snapshot of relevant statistics on Spain", Centre for Economic and Social Rights fact sheet No. 14 (2015).

[90] See E/C.12/ESP/CO/5; E/C.12/GRC/CO/2; E/C.12/PRT/CO/4; A/HRC/25/Add.1; UNICEF, "Austerity measures threaten children and poor households", working paper (September 2011); UNICEF, *Children of the Recession: The impact of the economic crisis on child well-being in rich countries* (New York, 2014); and ILO, *World Social Protection Report 2014-15* (Geneva, 2014).

[91] See G.A. Cordia, R. Jolly and F. Stewart, *Adjustment with a Human Face, Vol. II*, (Clarendon Press, Oxford, 1988).

[92] E/2013/82.

[93] See A/HRC/23/37.

54. Second, according to most studies, financial crises and the subsequent policy measures commonly implemented to alleviate their consequences, for example, fiscal retrenchment and stabilization policies, enhance inequalities, with devastating social consequences. A debt crisis may have a massive depressive impact on output, which may in turn affect the level of inequality. Most studies also concur that financial crises result in an increase in income inequality. Fiscal consolidation following a sovereign debt overhang may also have strong distributional consequences, both directly and indirectly, for example, through the increase in the unemployment rate and social spending cuts. The social effects of crises, hitting in particular the most vulnerable, are often catastrophic, with widespread poverty, the emergence of health issues, rising unemployment, to name only a few common problems.

55. The report has traced the numerous social and human rights dimensions of inequality and outlined corresponding human rights obligations of States. The finding that inequality may contribute to the occurrence of financial crises, which in turn exacerbate inequality and adversely affect human rights, has far reaching policy and legal implications. It underscores that human rights, social and economic aspects are inseparably intertwined, calling for a holistic approach to preventing and confronting financial crises. The report suggests that financial crises may not be prevented without addressing the contributing human rights shortcomings, including those connected to inequality. The same is true for crisis-response measures: any reaction to financial crises that neglects the effects on human rights and inequality does not only run afoul of human rights duties and responsibilities but also risks creating the same problems again and again, preventing any economically sustainable future. This lends additional urgency to the international community's commitment to reducing inequality reflected in Goal 10 of the Sustainable Development Goals.

B. Recommendations

56. Preventing and responding to financial crises and combating inequalities must thus go hand in hand. Hence, policymakers must ensure that they tackle dangerous destabilizing developments in the financial sphere while addressing inequality directly.

1. Financial markets regulation

57. States and the international community should urgently implement financial market reforms in order to combat and prevent financial instability, excessive debt and financial crises. The current prerogatives of largely unregulated global financial markets lead to instability both within many countries and on international markets, making financial crises much more likely. They undermine accountability and endanger democratic representation. Policymakers should use a mix of tools to ensure appropriate global and domestic financial market regulation with the aim of curbing excessive credit growth. This mix should include measures of prudential regulation, debt sustainability analysis and capital controls. In order to better fulfil its guiding function for policymaking, debt sustainability analyses should incorporate inequality as a crucial factor, making sure that the debtor States are able to achieve the Sustainable Development Goals and their human rights obligations.

2. Labour policies

58. Labour market institutions provide for powerful instruments for improving pre-tax income equality and should widely be employed. States should not shy away from robust wage legislation, including introducing or raising minimum wages and

legislation to ensure equal pay between genders. Moreover, it is crucial to safeguard sufficient bargaining power of the workforce. States should thus ensure that strong collective bargaining mechanisms are in place and may be used without interference. States should also make compliance with minimum wage and work conditions a precondition for eligibility to supply goods or services to public bodies.[94] In addition, in order to sustainably combat the widening of the wealth gap States should develop and strengthen frameworks encouraging and supporting small savings.

3. Fiscal policies

59. **Inequalities can be reduced through taxation and transfers, the latter including in cash and in kind.[95] In the field of taxation, there are numerous ways for addressing inequalities.[16] To start with, it is crucial to rely more on direct than indirect taxes as the latter tend to be regressive or proportional to incomes.[96] This is particularly true for excise duties and taxes.[97]**

60. **Income taxation needs to be aligned with a number of principles. First and foremost, tax progressivity is an important factor in fostering increased equality and should therefore be a prominent guiding principle of income taxation. Trends in the most recent decades of decreasing progressivity have massively contributed to the widening of the wealth and income gap. Moreover, tax progressivity decreases the probability of financial crises and default. The top marginal income tax rate should thus be considerably higher than what is currently common.[98] The minimum taxable income must always be above the poverty line.**

61. **In general, States should take care that capital income does not receive privileged treatment compared to income from labour, as is currently prevalent in many States. Obviously, this may call for amendments to applicable tax laws, but changes in other parts of the States' legal systems may also contribute to ending the special status of capital income, as described below.**

62. **Another important step towards increased equality should be to phase out certain tax deductions and excessive and unjustified tax privileges applicable to certain sources of income and sectors. Such privileges usually benefit the high earners disproportionally and thus foil progressive taxation.**

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[94] See A. B. Atkinsons, *Inequality: What can be done?* (Cambridge, Massachusetts, Harvard University Press, 2015), pp. 147-153.

[95] See the report of the Secretary-General on the role of the United Nations in promoting a new global human order and an assessment of the implications of inequality for development (A/67/394), para. 56, in which he exhorts that governments "may wish to consider a combination of progressive income taxes and highly redistributive transfers to decrease income inequality and its impact on social development".

[96] See "Fiscal policy and income", IMF policy paper (January 2014), p. 18; C. O'Donoaghue, M. Baldini, and D. Mantovani, "Modelling the redistributive impact of indirect taxes in Europe: an application of EUROMOD", Euromod working paper No. EM7/01 (Colchester, University of Essex, 2004); and S. Cnossen, *Theory and Practice of Excise Taxation: Smoking, Drinking, Gambling, Polluting, and Driving* (Oxford, Oxford University Press, 2005).

[97] See IMF, "Fiscal policy and income" (footnote 96).

[98] In J. Stiglitz, *The Price of Inequality: How Today's Divided Society Endangers Our Future* (New York, W.W. Norton and Company, 2012) pp. 273 ff., the author suggests that the top marginal tax rate should be well in excess of 50 per cent and plausibly in excess of 70 per cent; in A.B. Atkinson, in "Inequality: What can be done?" (footnote 94), pp. 179 ff., the author promotes a top marginal tax rate of 65 per cent.

63. **Introducing a wealth tax is another measure States should consider. Against the backdrop of increasing inequality, wealth taxes have recently found new attention[99] and may provide another way for increasing tax revenues while also fostering equality. States should also reassess other forms of taxation of property, including the transfer of assets. Broadening the tax base this way, and by closing loopholes in the tax code, has the benefit of improving both efficiency and equity.**[100]

64. **Furthermore, States should put an emphasis on fighting tax evasion and avoidance.**[101] **Tax loopholes used by wealthy individuals and multinational companies must be closed. Corporate tax minimizing strategies need to be addressed urgently. For this to be sufficiently effective, and in order to avoid detrimental outcomes for States advancing with such efforts, the work in this field, as in others discussed before, needs to be international in its scope.**

65. **Simultaneously, the findings of the report call for consistent public spending policies that ensure full compliance with the human rights obligations of the States. Such policies must first and foremost ensure that the human rights of the poorest and most vulnerable be respected, protected and fulfilled. They also must include decisive steps towards reversing the trend towards increasing inequality within and among States.**

66. **It is of utmost importance that States provide and progressively extend social protection floors, in accordance with the Social Protection Floor Initiative, the ILO Social Protection Floors Recommendation, 2012 (No. 202), and Goal 1.3 of the Sustainable Development Goals.**[102] **This entails at a minimum that "all in need have access to essential health care and to basic income security",**[103] **in particular for socially disadvantaged groups. However, States are under the obligation to work progressively towards the full realization of economic, social and cultural rights, using the maximum of the available resources. Consequently, States must continue further developing and extending their social systems, if resources permit. Cuts in social spending, and particularly social security and unemployment benefits, may only be made in cases of absolute necessity, after the most careful consideration of all alternatives, which may include tax reforms,**[16] **and only if they are duly justified by reference to the totality of the rights provided for in the Covenant in the context of the full use of the State party's maximum available resources (duty of non-retrogression).**[104]

67. **Public spending must be structured in a way that it benefits mostly persons and groups in need. Despite great efforts of many States and the international community, redistributive policies favour all too often the haves rather than the have-nots,**

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[99] See Piketty, *Capital in the Twenty-First Century* (footnote 4).

[100] See F. Cingano, "Trends in income inequality and its impact on economic growth", OECD Social, Employment and Migration Working Papers No. 163 (2014), para. 58.

[101] See the report of the Independent Expert (A/HRC/31/61).

[102] See the report of the Special Rapporteur on extreme poverty and human rights, Philip Alston, in which a thorough analysis of the linkages between social protection and human rights is provided (A/69/297), and Human Rights Council resolution 25/11.

[103] Sec. 4 ILO Social Protection Floors Recommendation, 2012 (No. 202).

[104] See Committee on Economic, Social and Cultural Rights, general comment No. 3, para. 9.

widening the income and wealth gap and making highly inefficient use of financial resources.[105]

4. Other measures

68. **Apart from more direct actions against inequality, States should have a focus on measures with strong medium- and long-term effects. Investment in education and the development of skills should be of highest priority, as it has robust and significant positive impacts on equality of opportunity, social mobility and long-term growth.**[106] **Furthermore, ensuring equal, affordable access to the courts and legal advice and representation, the establishment of low-cost dispute settlement mechanisms, a robust legislation on political parties financing and promoting a pluralistic mass media system, and strong consumer protection mechanisms should be on the agenda.**

69. **Finally, States and the international community should explore further avenues for reforming parts of their legal systems that appear to have a tendency towards unduly favouring capital owners and the wealthy.**[107] **Making adjustments to existing structures might be an efficient way for achieving necessary change without facing a similar degree of resistance than introducing, for example, new taxes.**

5. Crisis response

70. **It cannot be stressed too often that any response to financial crises, in particular sovereign debt crises, must fully comply with human rights law. In her report, the former Independent Expert on human rights and extreme poverty, Magdalena Sepúlveda Carmona, has already provided very detailed recommendations for such human rights compliant crises responses.**[107] **This report therefore focuses on highlighting only very few important aspects of relevance in the context of inequalities and financial crises. Fiscal stability and GDP may not be the sole targets of adjustment and may not overrule, suspend or dilute existing human rights obligations and responsibilities. Preserving economic, social and cultural rights, including the right to work social security, health, housing and education must be ensured.**[108] **Socioeconomic inequalities must be fully taken into account when implementing crises response measures. While certain spending cuts may be temporarily necessary, the States concerned must always respect the boundaries set by the duty of non-retrogression. They must ensure, to the extent possible, that social spending is affected last and the least. Rather, the States concerned should strongly focus on finding and creating progressive ways of increasing revenues. The protection of vulnerable groups must have the highest priority, calling, for example, for exemptions from cuts or even the implementation of new social protection programmes. The recent experiences of Iceland evidence that this approach is realistic and can yield fruitful results.**[109]

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[105] See A. Nieto Ramos, *El efecto de las pensiones sobre la desigualdad de ingresos en Colombia* (Bogotá, Universidad de los Andes, 2014). See also "Política fiscal y derechos humanos en las Américas" (footnote 16), p. 21.

[106] See S-I. Hsu, "The rise and rise of the one per cent: considering legal causes of wealth inequality", *Emory Law Journal Online*, vol. 64, pp. 2043-2072 (2015).

[107] See A/HRC/17/34.

[108] See the end-of-mission statement of the Independent Expert of his mission to Greece, December 8 2015, available from www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=16852&LangID=E.

[109] See the report of the Independent Expert on his mission to Iceland (A/HRC/28/59/Add.1).

71. **Crises responses, including any agreements between creditors and debtor States should comply with the principles of transparency, accountability and participation. Structural adjustment measures should be subjected to robust human rights impact assessments, both before the implementation and at regular intervals after. Both, creditors and debtors must honour their human rights obligations and responsibilities in their response to debt crises. This may include agreeing on sufficient debt relief in order to avert human rights violations and an exacerbation of inequality.**

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Final study on illicit financial flows, human rights and the 2030 Agenda for Sustainable Development of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights

Note by the Secretariat

The Secretariat has the honour to transmit to the Human Rights Council the final study on illicit financial flows, human rights and the 2030 Agenda for Sustainable Development of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Juan Pablo Bohoslavsky, submitted pursuant to Council resolutions 25/9 and 28/5. The final study complements the interim study of the Independent Expert (A/HRC/28/60) by focusing in more detail on the tax-related illicit financial flows: tax evasion by high net-worth individuals, commercial tax evasion through trade misinvoicing and tax avoidance by transnational corporations. In the study, the Independent Expert argues that curbing illicit financial flows and tax abuse is essential not only for realizing human rights, but also for achieving the Sustainable Development Goals, and concludes with recommendations addressed to States, international organizations and non-State actors.

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Final study by the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights

Contents

		Page
I.	Introduction	3
II.	Tax abuse: definitions and estimates	4
	A. Tax evasion	4
	B. Tax avoidance	6
III.	Tax abuse, human rights and sustainable development	7
	A. Equality and non-discrimination	8
	B. Economic inequality	8
	C. Relationship with sustainable development goals	9
IV.	Human rights obligations and tax abuse	11
	A. Maximum available resources	11
	B. International assistance and cooperation	11
	C. Use of funds	14
	D. Responsibilities of non-State actors	14
V.	Recent international initiatives to curb illicit financial flows	15
VI.	Achieving the Sustainable Development Goals	19
VII.	Conclusions and recommendations	19

I. Introduction

1. In its resolution 25/9, the Human Rights Council requested the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, to undertake a further study to analyse the negative impact of illicit financial flows on the enjoyment of human rights in the context of the post-2015 development agenda and to present an interim study to the Council at its twenty-eighth session and a final study at its thirty-first session. After presenting his interim study (A/HRC/28/60), the Council requested the Independent Expert in its resolution 28/5 to participate in the third International Conference on Financing for Development and to convene an expert meeting on funds of illicit origin with the view to include its outcome in his final study.

2. The Independent Expert welcomes the request to analyse the human rights implications of illicit financial flows, which divert resources away from activities that are critical for poverty eradication and sustainable economic and social development, as well as for realizing economic, social, cultural, civil and political rights and the right to development. Illicit financial flows also contribute to the build-up of unsustainable debt as Governments lacking domestic revenue may resort to external borrowing.

3. In May 2015, the Independent Expert provided comments on the draft outcome document of the third International Conference on Financing for Development in Addis Ababa to all member States. His interventions focused on ensuring better coherence of the outcome document with existing human rights obligations of States, with particular attention to the chapters covering illicit financial flows and foreign debt.[1]

4. Curbing illicit financial flows will be essential for realizing human rights and achieving sustainable development. The Independent Expert therefore welcomes the adoption of the outcome document of the third International Conference on Financing for Development, the Addis Ababa Action Agenda (General Assembly resolution 69/313, annex) and the Agenda 2030 for Sustainable Development (Assembly resolution 70/1). It is the first time that two key international documents recognize explicitly the detrimental effects of illicit financial flows on sustainable development. While the Millennium Development Goals had remained silent on the issue, States have now pledged to significantly reduce by 2030 illicit financial flows and strengthen the recovery and return of stolen assets (target 16.4) in the Agenda 2030. This can be considered a remarkable progress.

5. In his interim study, the Independent Expert discussed a large number of phenomena classified as illicit financial flows, including illegal tax evasion; tax avoidance by transnational corporations; bribery, corruption and concomitant asset recovery; and other criminal activities. While those activities negatively affect human rights in a number of ways, it has been estimated that the majority of all illicit financial flows are related to cross-border tax-related transactions. Curbing tax-related illicit financial flows thus has the potential to make the largest fiscal impact and would enlarge domestic resources available for the realization of human rights, including social, economic and cultural rights. The present study complements the interim study by focusing in more detail on the tax-related illicit financial flows: tax evasion by high net-worth individuals, commercial tax evasion through trade misinvoicing and tax avoidance by transnational corporations. It also explains the standing obligations of States under international law to counter these tax-related illicit financial flows.

[1] Available from www.ohchr.org/Documents/Issues/IEDebt/Paper3FFD22May2015.pdf.

6. The final study has been further developed on the basis of the inputs of the Independent Expert to the third International Conference on Financing for Development, as well as his participation in the conference and in two consultative events. On 29 October 2015, the Independent Expert convened a panel discussion on illicit financial flows, human rights and the post-2015 development agenda, on the margins of the seventieth session of the General Assembly in New York. In New Haven, Connecticut, on 30 October 2015, the Independent Expert participated in an expert meeting to discuss the study, organized in collaboration with the Yale University Global Justice Program and the organization Global Financial Integrity. The study also benefited from a background paper that was made publicly available before the consultations and from feedback received during the above-mentioned events.[2] The present study expands on certain aspects of the interim study, but should be read and considered in conjunction with it.

II. Tax abuse: definitions and estimates

7. Illicit financial flows can be defined narrowly or broadly. In their narrow sense, they refer to unrecorded financial flows involving funds that are illegally earned, transferred or utilized, for example, the profits of illegal activities, such as crime and corruption. Even if the funds originate from legitimate sources, however, their transfer abroad in violation of domestic laws, such as tax regulations, would render the capital illicit. Funds with a legitimate origin that are used for unlawful purposes, such as terrorist financing, would also be considered illicit. In their broader sense, illicit financial flows refer also to funds that, through legal loopholes and other artificial arrangements, circumvent the spirit of the law, including, for example, tax avoidance schemes used by transnational corporations.

8. The present study adopts the broad definition of illicit financial flows, covering both illegal tax evasion and legally questionable tax avoidance. While practices such as aggressive tax planning and harmful profit-shifting are frequently considered legal by domestic courts, as it is often difficult to provide sufficient evidence that highly complex tax optimization activities involving multiple jurisdictions violate national law, many such practices still give rise to legal concerns, rendering them a grey zone of compliance with national and international law.[3]

A. Tax evasion

9. As the Independent Expert discussed in his interim study, jurisdictions with high levels of financial secrecy can attract all kinds of illicit funds. Combined with low tax rates, they become ideal locations for tax-evading funds. Many important secrecy jurisdictions are home to a large private banking industry that facilitates tax evasion by high net-worth individuals in a systematic manner. Through the use of "shell" companies and other corporate vehicles, accounts can be rendered anonymous and funds can reside untaxed or minimally taxed with no means of identifying to whom they belong. It is essential to note

[2] See Esther Shubert, "Illicit financial flows, tax and human rights", background paper, 9 October 2015, available from www.ohchr.org/Documents/Issues/IEDebt/IllicitFinancialFlowsConsultation/BackgroundPaperFinal.pdf.

[3] See, for example, David Quentin, "Risk-mining the public exchequer", available from www.davidquentin.co.uk/Risk-Mining_The_Public_Exchequer.pdf.

that many of the world's most important secrecy jurisdictions are developed countries, which have historically been overlooked in their role in facilitating tax evasion.[4]

10. While not all wealth held offshore may be hidden from national tax authorities, a significant amount is believed not to be declared appropriately. Given the nature of the secrecy involved, estimating how much private wealth is hidden in tax havens is difficult and must be done indirectly. Estimates vary greatly, but in all the figures are substantial. One report estimates that $7.6 trillion (8 per cent of global financial household wealth) was held in tax havens at the end of 2013 — with an estimated 80 per cent of it unrecorded.[5] Another estimates the value of global private wealth held offshore in 2013 to be $8.9 trillion,[6] while yet another estimates that, at the end of 2010, unrecorded private wealth invested offshore was as much as $21 trillion to $32 trillion (10-15 per cent of global financial wealth). A more recent estimate is even higher: $24 trillion to $36 trillion as of 2015.[7] Those estimates provide only lower bound figures, since they include only financial wealth and disregard real assets, such as real estate, art, jewellery and gold, among others.

11. There is also consensus that the amount of private wealth held offshore is growing. It has been estimated that global offshore wealth increased by 28 per cent from end-2008 to end-2013,[8] and that unrecorded offshore private wealth grew at an average rate of 16 per cent a year from 2004 to 2014.[9] This trend is especially strong in developing countries.

12. Developed and developing countries suffer as a result, but developing countries are particularly hard hit. It has been estimated that the relative amount of wealth from developing countries held abroad is much greater than for developed countries, ranging from 20-30 per cent in many African and Latin American countries.[10] Another study provides similar figures: 26 per cent for Latin America and 33 per cent for the Middle East and Africa.[11] Moreover, developing countries tend to have much smaller tax revenues per capita than developed countries, further magnifying the impact of these losses for developing countries. The United Nations Conference on Trade and Development (UNCTAD) has calculated that the tax gap for developing countries is $66 billion to $84 billion per year — about two thirds of total official development assistance (ODA).[12] These revenues become lost from the erosion of the tax base, thus preventing Governments, particularly in developing countries, from establishing progressive tax systems.

13. Another crucial fact to note is the greatly unequal ownership of offshore wealth. It has been estimated that 85 to 90 per cent of wealth belongs to fewer than 10 million people — just 0.014 per cent of the world's population —, and at least a third of it belongs to the world's top 100,000 families, each with a net worth of at least $30 million.[13] Another study has found that, while offshore assets are rising, the number of clients is falling, so the

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[4] See, for example, the Tax Justice Network Financial Secrecy Index, available from www.financialsecrecyindex.com/.

[5] See G. Zucman, "Taxing across borders: tracking personal wealth and corporate profits", *Journal of Economic Perspectives*, vol. 28, No. 4, pp. 121-148.

[6] See Boston Consulting Group, "Global wealth 2014: riding a wave of growth" (2014).

[7] See J. Henry, "The price of offshore revisited", Tax Justice Network (2012); and "Let's tax anonymous wealth!", *Global Tax Fairness*, Ed. T. Pogge and K. Mehta (Oxford University Press, Oxford, forthcoming).

[8] See Zucman, "Taxing across borders" (footnote 6).

[9] See Henry, "Let's tax anonymous wealth!" (footnote 8).

[10] See Zucman, "Taxing across borders" (footnote 6).

[11] See Boston Consulting Group, "Global wealth 2013: maintaining momentum in a complex world", (2013).

[12] See *Trade and Development Report*, (United Nations publication, Sales No. E.14.II.D.4) p.175.

[13] See Henry, "Let's tax anonymous wealth!" (footnote 8).

average wealth per client is growing.[14] This means that the global reduction in tax revenues accrues almost entirely to the wealthiest. In this way, moving funds abroad to facilitate tax evasion promotes and perpetuates wealth inequality.

14. A common commercial tax-evading practice is trade misinvoicing. This involves falsifying trade documents, such as customs forms. By underinvoicing exports and overinvoicing imports, tax evaders can move assets out of countries and into secret bank accounts and shell companies in tax havens.

15. According to Global Financial Integrity, trade misinvoicing is the most common way of illicitly moving funds out of developing countries. The organization has estimated that trade misinvoicing accounted for more than 80 per cent of all illicit outflows between 2004 and 2013 — an average $655 billion per year — and that it roughly doubled in magnitude over this time period.[15] An analysis by the organization shows that in 7 out of the past 10 years, the global volume of illicit financial outflows from developing countries — of which trade misinvoicing constitutes the vast majority — was greater than the combined value of all ODA and foreign direct investment (FDI) flowing into poor nations.[16]

16. Importantly, these estimates are thought to be conservative since they account for only one type of trade misinvoicing, known as "re-invoicing," which occurs when goods are exported under one invoice, the invoice is then sent to another jurisdiction, such as a tax haven, where the price is altered, and finally, the revised invoice is sent to the importing country for clearing and payment. They do not account for misinvoicing on trade of services and intangibles — approximately 20 per cent of world trade —, nor does it capture "same invoice faking," where misinvoicing occurs within the same invoice as agreed between exporters and importers. A study by Global Financial Integrity has found that tax revenue losses to developing countries due to re-invoicing alone amounted to $98 billion to $106 billion per year between 2002 and 2006.[17]

B. Tax avoidance

17. While tax evasion, which breaks national tax laws, is openly illegal, a number of corporate tax avoidance schemes use very complex methods to make it very difficult for tax authorities to provide sufficient proof that they are in contravention of national laws and regulations. The overall effect of those practices is to reduce the corporate tax base of many countries in a way not intended by domestic policy. In addition, tax avoidance by transnational corporations harms society by avoiding a "fair share" of the tax burden.

18. A common method of corporate tax avoidance is "profit-shifting", where transnational corporations take advantage of tax rate differentials across jurisdictions and shift taxable income and assets away from source countries, where economic activity takes place, and into associated companies in tax havens, sometimes with no real staff or business activities.

19. Like tax evasion, tax avoidance results in tax revenue losses for both developed and developing countries. UNCTAD has estimated tax revenue losses to developing countries

[14] See Zucman, "Taxing across borders" (footnote 6).

[15] See D. Kar and J. Spanjers, "Illicit financial flows from developing countries: 2004-2013", Global Financial Integrity, p. 1 and 10 (2015).

[16] Ibid.

[17] See A. Hollingshead, "The implied tax revenue loss from trade mispricing", Global Financial Integrity, p. 1 (2010).

of $100 billion annually, which represents about one third of corporate income taxes that would be due in the absence of profit-shifting. Total development resource leakages, including lost earnings from missed reinvestment opportunities in addition to tax revenue losses, are an estimated $250 billion to $300 billion per year. These estimates are likely to be lower bound figures, since they do not cover all forms of corporate tax avoidance.[18] A recent study by the International Monetary Fund (IMF) estimates long-run annual revenue losses to developing countries of $200 billion per year (1.7 per cent of gross domestic product (GDP)) and to countries of the Organization for Economic Cooperation and Development (OECD) of $500 billion per year (0.6 per cent of GDP).[19] Looking specifically at the United States of America, one report estimates losses due to profit-shifting by United States firms to be $100 billion per year, while another calculates a decline in the effective tax rate on United States firms from 30-20 per cent over the past 15 years, two thirds of which is attributable to profit-shifting.[20] These losses are borne by both the Government of the United States and the Governments of other countries, while the benefits accrue to shareholders of the respective companies. Since equity ownership is very concentrated, so too, therefore, are these benefits. Similar trends can also be observed in other developed countries.

20. Corporate tax avoidance causes additional problems beyond lost revenue. The preceding suggests that corporate tax avoidance perpetuates inequality since the benefits accrue to a small minority while revenue losses will need to be made up by the rest of the population. Moreover, in developing countries, it decreases the competitiveness of domestic businesses since, unlike transnational corporations, they generally cannot take advantage of cross-border tax haven transactions in order to minimize their tax bill.[21] Tax avoidance also wastefully increases the cost tax administration.[22] Furthermore, the more sophisticated tax avoidance schemes become, the more ineffective capacity-building efforts to strengthen tax administrations become. This suggests that, while capacity-building efforts are important to help combat tax avoidance in the short term, what is needed more fundamentally is a change in the rules themselves.

III. Tax abuse, human rights and sustainable development

21. The Independent Expert notes in his interim study that there are various connections between illicit financial flows and human rights. Many of these also apply specifically to tax abuse. First and foremost, tax abuse deprives Governments of resources required to progressively realize human rights, including economic, social and cultural rights, such as health, education, social protection, water, sanitation, as well as civil and political rights, including access to justice, free and fair elections, freedom of expression and personal security. Tax abuse can also undermine the rule of law, for example, when large-scale tax evasion is allowed to occur with impunity. In addition, whistle-blowers, media outlets and human rights defenders that expose tax abuse require effective protection based on international human rights law and the United Nations Convention against Corruption. Human rights and due process guarantees are also essential to protect persons from undue

[18] See A. Cobham, "UNCTAD study on corporate tax in developing countries", *Unacounted.org* (2015).

[19] E. Crivelli, R. De Mooij and M. Keen, "Base erosion, profit shifting and developing countries", IMF working paper No. WP/15/118, pp. 19-20 (2015).

[20] See J. Gravelle, "Tax havens: international tax avoidance and evasion", Congressional Research Service (2015); and Zucman, "Taxing across borders" (footnote 6).

[21] See ActionAid, "How tax havens plunder the poor", p. 6 (2013).

[22] See Declaration of the Independent Commission for the Reform of International Corporate Taxation, p. 9, available from www.icrict.org/declaration/.

allegations, undue removal from office, criminalization, freezing or confiscation of assets or arbitrary deprivation of property or detention (see A/HRC/28/60, para. 22).

22. It is also worth emphasizing the connections between tax abuse and the principle of equality and non-discrimination contained in international human rights law, economic inequality and sustainable development.

A. Equality and non-discrimination

23. The principles of equality and non-discrimination are enshrined in all core international human rights instruments, including the Universal Declaration of Human Rights, the International Covenant on Civil and Political Rights, the International Covenant on Economic, Social and Cultural Rights, the International Convention on the Elimination of All Forms of Racial Discrimination and the Convention on the Elimination of All Forms of Discrimination against Women. Under article 2 of the International Covenant on Economic, Social and Cultural Rights, each State Party is required to ensure that the rights enshrined in the Covenant are guaranteed to all individuals under its jurisdiction without discrimination. In general comment No. 20 (E/C.12/GC/20), the Committee on Economic, Social and Cultural Rights elaborates that "[n]on-discrimination and equality are fundamental components of international human rights law and essential to the exercise and enjoyment of economic, social and cultural rights" and "[t]he principles of non-discrimination and equality are recognized throughout the Covenant".

24. Tax abuse by corporations and high net-worth individuals forces Governments to raise revenue from other sources, including through regressive taxes, the burden of which falls hardest on the poor (see A/HRC/26/28, para. 60). This has important human rights implications because regressive tax structures limit the redistributive impact of social programmes since they effectively end up being funded by the very people they are supposed to benefit. The need to make up revenue shortfalls through regressive taxes thus further undermines the realization of economic and social rights for the most vulnerable.

25. This has further implications for gender equality. When low-income households face deteriorating public services, many women and girls are forced to take on the additional costs of unpaid care needs. Moreover, tax systems themselves are not gender neutral and regressive taxes, such as consumption taxes, tend to disproportionately fall on women (see A/HRC/26/28, para. 46). In both cases, regressive taxes and their effects threaten to undermine substantive equality for women.

26. Finally, high levels of tax abuse undermine the principle of equality and non-discrimination, given that evaders end up paying less than taxpayers with the same, or less, capacity to pay (see A/HRC/28/60, para. 26 and A/HRC/26/28, para. 60).

B. Economic inequality

27. In addition, tax abuse perpetuates and exacerbates extreme economic inequality, benefiting the rich at the expense of the poor. While human rights law does not necessarily imply a perfectly equal distribution of income and wealth, it does require that resources in a society are distributed such that individuals are guaranteed equal enjoyment of their basic

rights without discriminatory outcomes.[23] When economic inequality results in such discriminatory outcomes, it becomes a human rights issue.

28. Global inequality currently stands at extremely high levels. The United Nations Development Programme (UNDP) reports that the richest 8 per cent of the world's population earn half of its total income, leaving the other half for the remaining 92 per cent.[24] Oxfam has shown that, in 2014, the richest 1 per cent of people in the world owned 48 per cent of global wealth — up from 44 per cent in 2010 —, leaving 52 per cent of global wealth to the remaining 99 per cent of the world's population. Oxfam predicts that, by 2016, half of global wealth will be concentrated among the top 80 individuals. Over the past two decades, income inequality has increased by 9 per cent in developed countries and 11 per cent in developing countries.[25] The Independent Expert shares the sentiment of the Special Rapporteur on extreme poverty and human rights, Philip Alston, who recently denounced such extreme inequality, calling it a "cause for shame".[26]

29. Extreme economic inequality threatens to undermine human rights. For example, income inequality prevents millions of individuals from enjoying social and economic rights on a non-discriminatory basis, such as access to adequate housing, food, health care and sanitation. This is particularly true if such inequality is not addressed by policies ensuring access to these rights, for example, through social welfare and protection. UNDP has calculated that, in 2012, 23 percentage points in the Human Development Index were lost owing to inequality. This can also result in negative feedback effects: a weakened tax base leads to poor social services and unequal treatment, which leads to the erosion of trust in government and to low taxpayer morale, which further weakens the tax base. It can also threaten the right to political participation, since outsize political influence by the rich can undermine democratic processes. Moreover, reminders of sharp differences in wealth can influence the way people view themselves and others, and can threaten the equal participation of citizens in political and public life.[27]

30. The Independent Expert welcomes the call from Special Rapporteur on extreme poverty for the Human Rights Council to recognize explicitly that there are limits to the levels of inequality that can be considered compatible with respect for human rights, and for States to make formal commitments to reducing extreme inequality.[28]

C. Relationship with sustainable development goals

31. Curbing tax abuse and illicit financial flows is not only essential for realizing human rights, but also for achieving sustainable development. Making progress on target 16.4 of the Sustainable Development Goals on reducing illicit financial flows will make an important contribution not only to achieve various other goals included in the Agenda 2030 for Sustainable Development, but also to the enjoyment of human rights.

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[23] R. Balakrishnan, J. Heintz and D. Elson, "What does inequality have to do with human rights?", Political Economy Research Institute, Working Paper Series No. 392 (2015); see also the annual report of the Independent Expert (A/HRC/31/60).

[24] See UNDP, *Humanity Divided: Confronting Inequality in Developing Countries*, p. xi (New York, 2013).

[25] See "Wealth: having it all and wanting more", Oxfam issue briefing, pp. 2, 3 and 7 (2015).

[26] See the report of the Special Rapporteur on extreme poverty and human rights (A/HRC/29/31) and his oral statement from 22 June 2015 to the Human Rights Council, available from www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=16131&LangID=E.

[27] See UNDP, *Humanity Divided*, pp. xi, 1 and 5-6 (footnote 26).

[28] See oral statement by the Special Rapporteur on extreme poverty and human rights (footnote 27).

32. While States have assumed binding human rights obligations going beyond their commitments to implement the Sustainable Development Goals, the Agenda 2030 for Sustainable Development is grounded in the Universal Declaration of Human Rights and international human rights treaties.[29] In some respects, the Agenda 2030 converges with obligations of States to progressively realize various economic, social and cultural rights. For example, the commitments to eradicate poverty (Goal 1), to end hunger and achieve food security and improved nutrition (Goal 2), to ensure healthy lives (Goal 3), to provide inclusive and equitable education (Goal 4), to ensure the availability of water and sanitation for all (Goal 6) and to promote full and productive employment and decent work for all (Goal 8) can contribute to the realization of the rights contained in the International Covenant on Economic, Social and Cultural Rights and other human rights treaties. Curbing illicit financial flows will also, as discussed above, help to reduce inequality within and between nations (Goal 10) and make a contribution to combating substantive discrimination. Curtailing illicit financial flows should therefore be seen not only as a target in its own right, but also as an important means for making progress on many of the other targets in the Agenda 2030.

33. A recent study by Global Financial Integrity has compared illicit financial outflows from the world's poorest economies to numerous traditional development indicators, including GDP, ODA and FDI, public expenditure on health and education and total tax revenues. The results of the study highlight the strong correlation between illicit financial flows and lower levels of development. For example, Global Financial Integrity estimates that 31 developing countries had illicit financial outflows greater than their public spending on health during the period 2008-2012 and, in 35 developing nations, illicit financial outflows outnumbered public spending on education during the same period. In 12 countries, illicit outflows were estimated to surpass total tax revenues. Finally, for 20 developing nations, illicit outflows outnumbered the combined financial inflow in the form of ODA and FDI during that period.[30] Such figures suggest that achieving the Sustainable Development Goals will be an immense uphill battle in the face of illicit financial flows.

34. The study by Global Financial Integrity also found that illicit financial flows correlate with lower levels of human development as measured by the Human Development Index, and with higher levels of poverty and economic inequality.[31]

35. Illicit financial flows will also pose a serious challenge to meeting target 17.4 of the Sustainable Development Goals, on debt sustainability. They can contribute to the build-up of debt crises since, in the face of missing revenues, some Governments must resort to external borrowing. Reducing illicit financial flows should therefore be seen as an important element in the fight against unsustainable debt. However, debt crises can aggravate illicit financial flows since high debt servicing expenses will reduce the amount of public resources available for other purposes, including combatting illicit financial flows. Progress made toward target 17.4 could therefore have positive impacts on the achievement of target 16.4, on illicit financial flows.

36. Finally, given that one of their most immediate consequences is the loss of tax revenue, illicit financial flows, and especially tax-related illicit financial flows, are clearly contrary to target 17.1 of the Sustainable Development Goals, on strengthening domestic resource mobilization, including through capacity-building for developing countries. In order to genuinely strengthen domestic resource mobilization, it will be necessary not only

[29] See General Assembly resolution 70/1, para. 10.

[30] See J. Spanjers and H. Foss, "Illicit financial flows and development indices: 2008-2012", Global Financial Integrity, pp. 30-33 (2015).

[31] Ibid, pp. 18-22.

to build capacity to help developing countries respond to the problems of tax abuse, but also to address the underlying, systematic causes of tax abuse and the policies and regulations that make it possible in the first place. It is important to recall here that raising tax revenue is not an end in itself, but rather a tool for development and the fulfilment of human rights. Governments that face difficulties in trying to address illicit financial flows must still ensure that tax systems are progressive and do not increase inequalities.

IV. Human rights obligations and tax abuse

37. As discussed by both the former Independent Expert on foreign debt, Cephas Lumina, and the former Special Rapporteur on extreme poverty, Magdalena Sepúlveda Carmona, international human rights instruments provide certain legal obligations that should guide the response to the problem of tax abuse.[32]

A. Maximum available resources

38. Under article 2 (1) of the International Covenant on Economic, Social and Cultural Rights, each State Party "undertakes to take steps, individually and through international assistance and cooperation, especially economic and technical, to the maximum of its available resources, with a view to achieving progressively the full realization of the rights recognized ... by all appropriate means, including particularly the adoption of legislative measures".

39. Part of the abovementioned obligation is the requirement to secure and devote the maximum available resources for the progressive realization of human rights. That means not only that Governments must use existing resources effectively, but also that, when necessary, they must increase revenue in equitable and non-regressive ways.[33] Moreover, as elaborated by the Committee on Economic, Social and Cultural Rights, each State party has an immediate obligation to ensure the satisfaction of, at the very least, minimum essential levels of all economic, social and cultural rights, and must demonstrate that every effort has been made to use all the resources at its disposal, to satisfy as a matter of priority those minimum obligations.[34] In other words, Governments that enact austerity measures without first looking out for any other way to raise revenue might not be acting in accordance with the Covenant, if such measures are regressive, result in discriminatory outcomes or deprive people of gaining access to minimum essential levels of rights. As the Special Rapporteur on extreme poverty argues, that includes resources that could potentially be collected through taxation, or tackling tax evasion and other illicit financial flows (see A/HRC/26/28, para. 27).

B. International assistance and cooperation

40. The obligation of States to provide international assistance and cooperation is enshrined in article 2 (1) of the International Covenant on Economic, Social and Cultural

[32] See A/HRC/22/42, A/HRC/25/52 and A/HRC/26/28.

[33] See R. Balakrishnan et al, *Maximum Available Resources and Human Rights*, Center for Women's Global Leadership (Rutgers University, New Brunswick, New Jersey, 2011).

[34] See Committee on Economic, Social and Cultural Rights, general comment No. 3 on the nature of States parties' obligations, para. 10.; and statement of the Committee on Economic, Social And Cultural Rights, (E/C.12/2007/1).

Rights.[35] According to the Committee on Economic, Social and Cultural Rights, the phrase "to the maximum of its available resources" refers both to resources existing within a State and those available from the international community through international cooperation and assistance.[36] The duty of States to make every effort to satisfy economic, social and cultural rights therefore includes an obligation to actively seek assistance through international cooperation.[37]

41. As the Special Rapporteur on extreme poverty explains, States have a corresponding duty "to provide international assistance and cooperation, commensurate with their capacities, resources and influence ... on the basis of the recognition that some countries will not be able to achieve the full realization of economic, social and cultural rights if other countries in a position to assist do not do so".[38]

42. While the Covenant refers in particular to economic and technical assistance and cooperation, international assistance may comprise other measures, including provision of information to people in other countries or cooperation with their State, for example, to trace stolen public funds.[39] This interpretation could be easily extended to apply to assistance in tackling tax evasion. Indeed, tax information exchange — a key measure for international tax cooperation — is becoming the new global standard and has been repeatedly emphasized throughout the Sustainable Development Goals process, including most recently in the Addis Ababa Action Agenda.

43. In our globalized world, policies implemented in one country can have impacts in other countries. This includes taxation policies, which can undermine the enjoyment of human rights abroad. International law requires that States should refrain from conduct that harms the enjoyment of human rights outside their own territory.[40] The duty to respect human rights requires that States not interfere or deliberately undermine efforts by other States to realize social, economic and cultural rights. Reaffirming principles of the Covenant and international law, the Maastricht Principles on Extraterritorial Obligations of States in the Area of Economic, Social and Cultural Rights state, for example, that all States "have the obligation to refrain from conduct which nullifies or impairs the enjoyment and exercise of economic, social and cultural rights of persons outside their territories" (Principle 20); and "must refrain from any conduct which ... impairs the ability of another State or international organization to comply with that State's or that international organization's obligations as regards economic, social and cultural rights" (Principle 21).

44. Following this line of reasoning, the International Bar Association on tax abuse, poverty and human rights released a report in which it argued that actions of States "that encourage or facilitate tax abuses, or that deliberately frustrate the efforts of other States to counter tax abuses, could constitute a violation of their international human rights obligations, particularly with respect to economic, social and cultural rights".[41] This concern was shared by the Independent Expert in his interim study, by the former

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[35] See Articles 55 and 56 of the Charter of the United Nations, article 4 of the Convention on the Rights of the Child and article 32 of the Convention on the Rights of Persons with Disabilities.

[36] See E/C.12/2007/1, para. 5.

[37] See A/HRC/26/28, para. 26.

[38] Ibid, paras. 29-32.

[39] O. De Schutter et al "Commentary to the Maastricht Principles on Extraterritorial Obligations of States in the Area of Economic, Social and Cultural Rights", *Human Rights Quarterly*, No. 34, p. 1157 (2012).

[40] See, for example, Articles 55 and 56 of the Charter of the United Nations, and the Draft Articles on the Responsibility of States for internationally wrongful acts (A/56/10).

[41] See S. Cohen et al, *Tax Abuses, Poverty and Human Rights*, International Bar Association, p. 2 (London 2013).

Independent Expert on foreign debt and by the former Special Rapporteur on extreme poverty.[42]

45. By reducing government revenue, tax abuse critically undermines the ability of many countries, especially the world's poorest countries, to fulfil economic, social and cultural rights. Poor countries have much smaller tax revenue bases than developed countries, due to having smaller per capita GDPs, as well as the fact that they raise a much smaller proportion of their gross GDP as government revenue.[43] As a result, many of these countries are dependent on external aid. For example, according to a UNDP report, in 2009 the least developed countries received approximately 24.1 per cent of total ODA, yet at the same time it has been estimated that as a group they lost 60 cents off every dollar of ODA to illicit financial flows. For some of these countries, illicit outflows were several times greater than the amount of ODA received. The report also found that illicit outflows averaged 4.8 per cent of the GDP of least developed countries, a large proportion of already vulnerable economies.[44]

46. A recent study by Global Financial Integrity also confirms that illicit financial flows have an outsize impact on the worst-off developing countries, including least developed countries and heavily indebted poor countries. The organization found that, of 82 developing countries studied, 20 per cent have illicit outflows greater than their ODA and FDI combined; for close to 25 per cent of countries, the ratio of illicit outflows to GDP is 10 per cent or greater; and, for 40 per cent of countries, the ratio of illicit outflows to total trade value was 10 per cent or greater. The study also shows that there is a strong connection between high levels of illicit outflows and the poverty gap (the number of people living below the poverty line), and an inverse relationship between high levels of illicit outflows and a country's ranking on the Human Development Index.[45]

47. Next to government revenue losses, tax abuse also strains the capacity of Governments that have the fewest resources to spare. The High-level Panel on Illicit Financial Flows from Africa has explained that finding the resources required to tackle tax abuse is difficult for many African Governments, even though they would pay off in the long run, since in the meantime they compete with other priorities for resource-strained Governments.[46]

48. It is also important to remember that tax abuse is problematic from a human rights perspective not only in terms of resources for fulfilling socioeconomic rights, but also because of its effects on governance and political institutions. High-profile tax abuse by the elite can lead to low tax morals and widespread non-compliance. It also undermines the legitimacy of the Government and the rule of law, while illicit funds and wealth concentrated in the hands of a small elite can increase the risk of regulatory capture and undermine the ability of the public to participate in political processes.

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[42] See A/HRC/28/60, para. 24; A/HRC/25/52, para. 25; and A/HRC/26/28, paras. 30-32, 61-62 and 74-77.

[43] See T. Pogge, "Illicit financial outflows as a drag on human rights realization in developing countries", in "Illicit Financial Flows: The Most Damaging Economic Condition Facing the Developing World", Global Financial Integrity, pp.15-16 (2015).

[44] See "Illicit financial flows from the least developed countries: 1990-2008", UNDP, pp. 3 and 16 (New York, 2011).

[45] See Spanjers and Foss, "Illicit financial flows" pp. vii-ix (footnote 31).

[46] See "Illicit financial flows", Report of the High-Level Panel on Illicit Financial Flows from Africa, p. 59, available from www.uneca.org/sites/default/files/PublicationFiles/iff_main_report_26feb_en.pdf.

49. Some critics have argued that having legislation favourable to the offshoring of private wealth is part of a jurisdiction's right to self-determination or sovereignty. The Independent Expert shares the view of the commission established by the Government of Norway to investigate capital flight from developing countries, that States do not have an unlimited license to pursue their own self-interest at any cost; indeed, the primary constraint on State sovereignty is that domestic policies should not undermine the sovereignty of another State. "Legislation that exclusively or primarily will have effects in other States, such as the financial regulations common to secrecy jurisdictions, is therefore not the exercise of sovereignty, but an encroachment on the sovereignty of others".[47]

C. Use of funds

50. It is important to emphasize that, since curtailing tax abuse would surely increase the fiscal space of Governments, these greater tax revenues must be spent with due respect for international human rights obligations. While human rights law gives States a lot of discretion to follow their own economic policies, there are certain limits. For example, States have to ensure that all persons enjoy at least minimum essential levels of satisfaction of each social, economic and cultural right. Furthermore, they have to devote maximum available resources to the progressive realization of social, economic and cultural rights. In addition, all rights need to be realized in a non-discriminatory manner. Human rights obligations in the economic and social sphere therefore demand some prioritization of public spending, including that public resources are used to ensure that marginalized groups enjoy the rights enumerated in the International Covenant on Economic, Social and Cultural rights and other human rights treaties, without discrimination.

51. This reasoning holds not only for the use of additional tax revenues. While illicit financial outflows may pose constraints on States to realize economic, social and cultural rights, that does not excuse budget allocations based on existing public revenues that would be in contradiction to the above mentioned principles.

52. Furthermore, it is the view of the Independent Expert that respect for and adherence to the human rights principles of transparency, accountability and participation is a critical factor in ensuring the prudent use of public funds.

D. Responsibilities of non-State actors

53. As the Independent Expert discussed in his interim study, tax abuse, and illicit financial flows more generally, is not a human rights concern for States alone. While States have the primary duty to respect, protect and fulfil human rights, Principle 13 (a) of the Guiding Principles on Business and Human Rights requires that business "[a]void causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur".[48]

54. The present study has already discussed how many transnational corporations employ aggressive tax planning strategies that amount to tax abuse. When it comes to tax evasion, financial institutions are also a key actor — including some of the world's largest and best-known banks. For the period 1998-2014, one author identified 845 cases in which

[47] See Commission on Capital Flight from Poor Countries, *Tax Havens and Development*, p. 145 (Government of Norway, Oslo, 2009).

[48] See Office of the United Nations High Commissioner for Human Rights, "Guiding principles on business and human rights" (New York and Geneva, 2011).

individual financial institutions received specific declared penalties and assessments for a host of infractions, the most widespread of which was helping wealthy clients and corporations engage in tax fraud. Moreover, it was found that a small handful of banks were responsible for a majority of those infractions: looking at the top 14 kinds of infractions, the top 22 banks were penalized a combined 655 times and the top 10 offenders account for more than half of these.[49]

55. The study calculated that the banks had paid a combined $11 billion in fines for facilitating tax evasion. However, those penalties, and those for other financial crimes, were only a modest share of their total assets. Moreover, of the cases reviewed, in only one — a tax evasion case — did a major bank ever plead guilty to a corporate felony. Even so, the bank in question did not have its license revoked; indeed, the plea deal was arranged so that this would not happen. There is furthermore a sense of impunity in relation to the conduct of senior bankers with respect to the financial crimes of their institutions.

56. Financial institutions that facilitate tax evasion and transnational corporations that employ aggressive tax planning strategies must recognize that their actions may have negative human rights impacts. They can demonstrate respect for human rights through appropriate policies and due diligence procedures, through country-by-country reporting, including publishing information about the taxes they pay to each country in which they operate. Similarly, the professionals that make up the tax planning industry, such as lawyers, accountants, bankers and wealth managers, must take responsibility for their contributions to the harms caused by tax abuse.

57. While businesses have human rights responsibilities and must follow domestic law, States have the duty to ensure that businesses operating in their territory do not abuse human rights. According to the Guiding Principles on Business and Human Rights, States (a) must protect against human rights abuse within their territory and/or jurisdiction by third parties, including business enterprises; this requires taking appropriate steps to prevent, investigate, punish and redress such abuse through effective policies, legislation, regulations and adjudication; and (b) should set out clearly the expectation that all business enterprises domiciled in their territory and/or jurisdiction respect human rights throughout their operations. A similar obligation can be found in principles 24 and 27 of the Maastricht Principles.

58. These requirements are relevant for addressing tax evasion facilitated by financial institutions and tax avoidance by transnational corporations. Governments must ensure that such organizations cease to be involved in those activities, which are detrimental to the full realization of human rights. Imposing sanctions and penalties on businesses for tax abuse might thus also form part to ensure human rights compliance. Furthermore, human rights impacts related to corporate tax abuse should also be considered in national action plans on business and human rights.

V. Recent international initiatives to curb illicit financial flows

59. In his interim study, the Independent Expert reviews a number of international initiatives to curb illicit financial flows. The Independent Expert wishes to draw attention here to a number of recent developments, updating the information contained in the interim study.

[49] See Henry, "Let's tax anonymous wealth!" (footnote 8).

High-level panel on illicit financial flows from Africa

60. The African Union and the Economic Commission for Africa established the High-level Panel on Illicit Financial Flows in February 2012 to address the debilitating problem of illicit financial outflows from Africa. The Panel carried out consultations, country visits and studies in six African countries to inform its report, which was launched in Addis Ababa on 1 February 2015. In the report, the Panel argues that illicit financial flows are a potential source of domestic resource mobilization for the continent that, if tapped, could have positive impacts in terms of development, reducing aid dependence and governance. The report ends with a series of policy recommendations, both for African countries and other actors.

Addis Ababa Action Agenda

61. The third International Conference on Financing for Development, held in Addis Ababa from 13-16 July 2015, adopted on its last day the Addis Ababa Action Agenda. The Agenda states that measures to curb illicit financial flows will be integral for achieving sustainable development (para. 18) and devotes a significant portion of its discussion of domestic public resources to combatting tax abuse. In paragraph 23 of the Addis Ababa Action Agenda, States made the following important commitments:

> We will redouble efforts to substantially reduce illicit financial flows by 2030, with a view to eventually eliminating them, including by combating tax evasion and corruption through strengthened national regulation and increased international cooperation. We will also reduce opportunities for tax avoidance, and consider inserting anti-abuse clauses in all tax treaties. We will enhance disclosure practices and transparency in both source and destination countries, including by seeking to ensure transparency in all financial transactions between Governments and companies to relevant tax authorities. We will make sure that all companies, including multinationals, pay taxes to the Governments of countries where economic activity occurs and value is created, in accordance with national and international laws and policies.

62. Furthermore, in paragraph 25 of the Addis Ababa Action Agenda, States committed themselves to strive to eliminate safe havens that create incentives for transfer abroad of stolen assets and illicit financial flows and to strengthen regulatory frameworks at all levels, to further increase transparency and accountability of financial institutions, the corporate sector and public administrations.

63. The Independent Expert welcomes many elements of the Addis Ababa Action Agenda, including its explicit call to respect human rights and the specific attention it gives to tax abuse, including both tax evasion and avoidance. However, several concerns raised by the Independent Expert during the preparatory process of the Conference were ultimately not addressed in the final outcome document. He worried, for example, about the vagueness of the commitments to "substantially reduce" and "eventually eliminate" illicit financial flows, and recommended that a more measurable target with a specific deadline be included.[50] He also argued that, to fully do justice to the human rights concerns raised by tax abuse, more explicit references to tackling secrecy jurisdictions, strengthening bank oversight and ensuring that financial service providers exercise due diligence would be needed. Yet the final language adopted remains weak, as it is unclear what counts as a "safe haven" and what exactly States and financial institutions must do in order to reduce the

[50] See comments by the Independent Expert of 26 May 2015, available from www.ohchr.org/Documents/Issues/IEDebt/Paper3FFD22May2015.pdf.

incentives for tax abuse. Similarly, it is unclear how regulative frameworks must be strengthened to increase the transparency and accountability of financial institutions.[51] Concrete proposals are crucial to ensuring that progress in curbing tax abuse can be made.

Tax Inspectors Without Borders

64. The third International Conference on Financing for Development also saw the launch of Tax Inspectors Without Borders, an OECD/UNDP joint initiative to help developing counties bolster domestic revenues by strengthening their tax audit capacities. The programme will facilitate the transfer of tax audit knowledge and skills by matching tax audit experts with local officials to work directly on current audits concerning international issues, and to share general audit practices. The initiative was welcomed by stakeholders from business and civil society, as well as OECD and developing countries in Addis Ababa.[52] While the provision of technical assistance to developing countries is welcome and necessary, adequate care needs to be taken to avoid conflicts of interest. For example, there have been concerns that some tax experts providing advice have previously assisted transnational corporations in negotiating problematic advance pricing agreements for them or assisted them in other ways to avoid tax payments.

2030 Agenda for Sustainable Development

65. At the United Nations summit for the adoption of the post-2015 development agenda, held in New York on 25-27 September 2015, Member States adopted 17 Sustainable Development Goals, including two targets particularly relevant to illicit financial flows. Target 16.4 of the Goals commits States to "significantly reduce illicit financial and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organized crime" by 2030. Under target 17.1, States agreed to strengthen domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection. The outcome document of the United Nations summit for the adoption of the post-2015 development agenda (General Assembly resolution 70/1, annex), also mentions that the full implementation of the Addis Ababa Action Agenda is critical for the realization of the Sustainable Development Goals and targets.

66. There were no similar commitments relating to illicit financial flows and support for domestic revenue generation in the Millennium Development Goals, including Goal 8 on global partnership for development, covering foreign debt, trade and development cooperation. The Independent Expert therefore welcomes the inclusion of these targets on illicit financial flows into the Sustainable Development Goals.

Organization for Economic Cooperation and Development projects on automatic exchange of tax information and base erosion and profit-shifting

67. In response to public outcry over tax evasion and corporate tax avoidance, the Group of Eight countries made a commitment at its 39th summit, in June 2013, to introduce automatic exchange of information by tax authorities across the world in order to fight the scourge of tax evasion; to change rules that let companies shift their profits across borders to avoid taxes; to assist developing countries with information and capacity to collect taxes

[51] See J.P. Bohoslavsky, "Why the Addis debt chapter falls short", *The Road to Addis and Beyond: Financing for Social Development*, United Nations Research Institute for Social Development (2015).

[52] See www.undp.org/content/undp/en/home/presscenter/pressreleases/2015/07/13/tax-inspectors-without-borders-oecd-and-undp-to-work-with-developing-countries-to-make-tax-audits-more-effective.html.

owed to them; to introduce public country-by-country reporting for extractive companies; and to address the issue of misuse of shell companies to facilitate illicit financial flows.[53]

68. In July 2014, OECD and the Group of 20 published a new global standard for automatic exchange of tax information, providing for the exchange of non-resident financial account information with the tax authorities in the account holder's country of residence. As at 30 October 2015, 96 countries had committed themselves to implementing the standard to automatically exchange tax information by end of 2018.[54]

69. OECD was also tasked by the Group of Eight and Group of 20 Finance Ministers with developing an Action Plan on Base Erosion and Profit-Shifting, published in July 2013, containing 15 specific actions to address a range of issues relating to tax transparency, accountability and information exchange. The final package of reforms was endorsed by the Group of 20 Finance Ministers in Lima on 8 October 2015, and subsequently presented to the Group of 20 leaders during their summit in Antalya, Turkey, on 15 and 16 November 2015. The leaders called on OECD to develop a framework for monitoring the implementation of the base erosion and profit-shifting project by 2016 and to encourage all countries and jurisdictions, including developing countries, to participate in it. While that project includes country-by-country reporting by transnational corporations as one of its action points, it requires that this information be provided only to the home tax authority of those corporations and not that it be made publicly available. Other countries will likely be able to access that information only through official treaty requests, which will make it more difficult for developing country tax authorities to access the information and will prevent public scrutiny.

Independent Commission for the Reform of International Corporate Taxation

70. The Independent Commission for the Reform of International Corporate Taxation is a group of leaders from around the world that aims to promote the reform of the international corporate tax system. The Commission met in New York on 18 and 19 March 2015 and launched its Declaration[55] in Trento, Italy, in June 2015. In its preamble, the Declaration states:

> With the conviction that our system of taxing the global profits of transnational corporations is broken and that the rules and institutions governing the international corporate tax system must change, we have formed an Independent Commission for the Reform of International Corporate Taxation. As a Commission, we have concluded that proposals to reform the current system are clearly insufficient, and the institutions promoting international tax cooperation are not inclusive enough.

The Declaration provides 34 reform proposals in six different areas "to ensure the creation of an international tax system that works for all people." One of its key recommendations is to tax transnational corporations conducting business activities across international borders with subsidiaries in different jurisdictions as single firms.

[53] See www.gov.uk/government/publications/g8-action-plan-principles-to-prevent-the-misuse-of-companies-and-legal-arrangements/g8-action-plan-principles-to-prevent-the-misuse-of-companies-and-legal-arrangements.

[54] See www.oecd.org/newsroom/global-forum-on-tax-transparency-pushes-forward-international-co-operation-against-tax-evasion.htm.

[55] Available from www.icrict.org/declaration/.

VI. Achieving the Sustainable Development Goals

71. In the view of the Independent Expert, implementing the Sustainable Development Goals target on illicit financial flows will be a challenge. First, it is only one of 169 targets included in the Agenda 2030 for Sustainable Development. Second, there are many actors with different and sometimes conflicting interests who need to work together in order to make progress on this particular target. The more actors there are, the greater the risk of diffusion of responsibility for implementation, if it is not clearly spelled out who should do what and when.

72. This raises the question of accountability for implementing the Sustainable Development Goals and monitoring their implementation. So far, it is largely left to States to honour their commitments. But commitments are not likely to be honoured if one cannot point at responsibility for specific action and if there is no public pressure to take action. Hence, the need for a rigorous and independent monitoring mechanism.

73. In this context, it will also be essential to track progress on reducing illicit financial flows through appropriate indicators. The United Nations Inter-Agency and Expert Group on Sustainable Development Goal Indicators is currently developing such indicators but, as at December 2015, consensus had not been reached as to how to measure progress in reducing illicit financial flows, which will require agreeing on a common method for estimating illicit financial flows under the Sustainable Development Goals framework. To maintain accountability, it will be necessary to track and measure not only illicit financial flows themselves, in terms of volume, but also policy efforts to reduce them, both in countries of origin and countries of destination.

74. Finally, it will be necessary to have robust and independent mechanisms to ensure that the commitments made in Addis Ababa and in New York are closely watched, not only by States and bodies of the United Nations, but also by academic experts and civil society.

VII. Conclusions and recommendations

75. **Combating tax abuse, and illicit financial flows more broadly, is essential to make better progress in realizing international human rights obligations. The inclusion of a specific target to reduce illicit financial flows under the Sustainable Development Goals makes clear that curbing such flows is also essential for creating an enabling environment for sustainable development.**

76. **While the Independent Expert applauds that reducing illicit financial flows is mentioned in one of the targets of the Sustainable Development Goals, the target remains broad and vague. Specific measures to operationalize this target are needed to ensure that progress is achieved and that such progress can be tracked and measured.**

77. **In developing his recommendations, the Independent Expert considered previous recommendations by the Special Rapporteur on extreme poverty and by his predecessor, and the recommendations contained in his interim study.[56] He also took note of recommendations made by the High-level Panel on Illicit Financial Flows from Africa, the commitments contained in the Addis Ababa Action Agenda and recommendations by independent expert bodies, such as the Independent Commission**

[56] See A/HRC/25/52, para. 50; A/HRC/26/28, paras. 79-82; and A/HRC/28/60, para. 77.

for the Reform of International Corporate Taxation. To promote accountability, his recommendations are addressed to specific stakeholders.

Recommendations to Member States

78. States should ensure that human rights are respected and advanced in all measures and activities undertaken to curb illicit financial flows.

79. States should actively participate in the global movement towards automatic exchange of tax information, in order to prevent hiding of offshore assets and income streams. Out of consideration for the unique challenges faced by developing countries, and in the spirit of the principle of common but differentiated responsibilities, there should be a fixed transition period during which lower-income countries receive tax information automatically without a requirement for full reciprocity. This will allow time for their domestic systems to be modified and improved, so that they are able to take full advantage of the benefits of information exchange.

80. States should impose a legal requirement for the public disclosure of beneficial ownership information, in order to eliminate the potential for anonymous ownership of companies, trusts and foundations.

81. States should require transnational businesses to report publicly on a country-by-country basis, in order to expose major misalignments between the distribution of profit and the location of real economic activity. These reports should be made freely available to tax administrations and should be made available to the public within a certain period of filing.

82. States must hold financial institutions to account for their role in facilitating tax evasion. Robust regimes should be put in place for the supervision of financial institutions by financial supervision agencies. Such regimes should require mandatory reporting of transactions that may involve illicit activity. States should ensure that financial and service providers comply with strict due diligence procedures, as laid out, for example, in the Financial Action Task Force recommendations.

83. States should conduct human rights impact assessments of their tax policies, to ensure that they do not have negative impacts abroad. These should be periodic and independently verified, with public participation in defining the risks and potential extraterritorial impacts. Impact assessments should analyse not only the implications for revenue streams, but also the distributive and governance spillover effects of a country's tax regime abroad. If and when negative spillovers are found, impact assessments should trigger policy action including explicit recommendations for responsible parties and clear deadlines for remedies and redress.

84. States should ensure that human rights impacts caused by corporate tax abuse should form part of due diligence required by business actors and addressed in national action plans on business and human rights.

85. States should uphold their commitments in the Addis Ababa Action Agenda and target 17.1 of the Sustainable Development Goals with respect to capacity-building for tax administrations, including through targeted use of ODA. Technical assistance and other forms of support should also be provided, including through South-South cooperation or participation in the Addis Tax Initiative, launched at the third International Conference on Financing for Development.

86. Capacity-building initiatives in other key areas for fighting tax abuse should receive similar support. To curb trade misinvoicing, developed countries should contribute toward the development of a global trade-pricing database that would give customs officials access to global average price of products. Financial and other forms

of assistance should also go toward training and equipment for customs departments, to better detect intentional misinvoicing of trade transactions. Increased support should also go to financial intelligence units to better track illicit outflows and to financial crime units to prosecute them.

87. **States of origin should:**

(a) **Ensure that they have clear and concise laws and regulations that make it illegal to intentionally incorrectly or inaccurately state the price, quantity, quality or other aspect of trade in goods and services in order to move capital or profits to another jurisdiction or to manipulate, evade or avoid any form of taxation, including customs and excise duties;**

(b) **Establish transfer pricing units within their revenue authorities;**

(c) **Require their customs officials to use available databases of information about comparable pricing of world trade in goods to analyse imports and exports and identify transactions that require additional scrutiny;**

(d) **Review their current and prospective double taxation agreements, particularly those in place with jurisdictions that are significant destinations of illicit financial flows, to ensure that they do not provide opportunities for abuse.**

88. **In the long term, the system for taxing a transnational corporation's subsidiaries as separate entities should be replaced by a system of taxing transnational corporations as single and unified firms. Member States should initiate negotiations to draft a United Nations convention to combat abusive tax practices, which should evolve into a convention that would adopt a consolidation and apportionment system for taxing global corporate profits.**

Recommendations to international organizations and international financial institutions

89. **The Committee of Experts on International Cooperation in Tax Matters should be further strengthened and made more inclusive, with increased representation from lower-income countries, so that it can act as global forum for norm setting on tax matters. It should be provided with adequate, non-discretionary funding and resources.**

90. **The IMF and World Bank should publish estimates of the volume and composition of illicit financial flows on an annual basis to monitor progress in implementing target 16.4 of the Sustainable Development Goals on illicit financial flows.**

91. **Progress in reducing illicit financial flows should be tracked within the Sustainable Development Goals framework by a second indicator monitoring policy efforts to curb illicit financial flows by countries of origin and destination. The Financial Secrecy Index could provide an inspiration.**[57]

92. **The Bank of International Settlements should publish its data on international banking assets by country of origin and county of destination.**

93. **Multilateral organizations should develop model provisions to protect whistleblowers that disclose abusive tax practices to address gaps in their protection. Civil society participation should be included in this process.**

[57] See www.financialsecrecyindex.com/.

94. **International human rights mechanisms should pay greater attention to the impacts of illicit financial flows, tax evasion and tax abuses on the enjoyment of human rights. This should include also monitoring the use of public funds in line with obligations contained in international human rights standards.**

Recommendations to non-State actors

95. **Transnational corporations should exercise due diligence in relation to tax evasion and tax avoidance to meet due diligence requirements under the Guiding Principles on Business and Human Rights. Business enterprises should publish the taxes they pay to every State where they operate, as part of their corporate social responsibility reporting.**

96. **The United Nations Global Compact should be strengthened by explicitly recognizing the obligation to pay tax in a fairly manner as a central element of corporate social responsibility. An international code of tax conduct for transnational corporations should be developed and signed by multinational corporations.**

97. **Commercial banks, financial institutions, financial service providers, tax lawyers and accountants should exercise due diligence with their clients and not participate in business activities that have the principal goal of facilitating tax evasion and avoidance undermining the enjoyment of human rights. Industry and profession specific guidelines should be developed to ensure compliance.**

98. **Civil society organizations should continue to play an active role in the monitoring and review process of the Agenda 2030 for Sustainable Development to ensure that progress on target 16.4 is achieved, and that all relevant actors are held to account.**